S. Hrg. 108–369

THE REPORT OF THE PRESIDENTIAL COMMISSION ON THE U.S. POSTAL SERVICE: PRESERVING ACCESS AND AFFORDABILITY

HEARING

BEFORE THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

FIRST SESSION

NOVEMBER 5, 2003

Printed for the use of the Committee on Governmental Affairs

U.S. GOVERNMENT PRINTING OFFICE

91–039 PDF WASHINGTON : 2003

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

COMMITTEE ON GOVERNMENTAL AFFAIRS

SUSAN M. COLLINS, Maine, *Chairman*

TED STEVENS, Alaska
GEORGE V. VOINOVICH, Ohio
NORM COLEMAN, Minnesota
ARLEN SPECTER, Pennsylvania
ROBERT F. BENNETT, Utah
PETER G. FITZGERALD, Illinois
JOHN E. SUNUNU, New Hampshire
RICHARD C. SHELBY, Alabama

JOSEPH I. LIEBERMAN, Connecticut
CARL LEVIN, Michigan
DANIEL K. AKAKA, Hawaii
RICHARD J. DURBIN, Illinois
THOMAS R. CARPER, Delaware
MARK DAYTON, Minnesota
FRANK LAUTENBERG, New Jersey
MARK PRYOR, Arkansas

MICHAEL D. BOPP, *Staff Director and Chief Counsel*
ANN C. FISHER, *Deputy Staff Director*
JOYCE A. RECHTSCHAFFEN, *Minority Staff Director and Chief Counsel*
SUSAN E. PROPPER, *Minority Counsel*
AMY B. NEWHOUSE, *Chief Clerk*

CONTENTS

	Page
Opening statements:	
Senator Collins	1
Senator Akaka	4
Senator Stevens	5
Senator Carper	7
Senator Pryor	9

WITNESSES

WEDNESDAY, NOVEMBER 5, 2003

Hon. John E. Potter, Postmaster General, U.S. Postal Service	10
Hon. David M. Walker, Comptroller General, U.S. General Accounting Office (GAO)	17

ALPHABETICAL LIST OF WISTNESSES

Potter, Hon. John E.:	
Testimony	10
Prepared Statement	27
Walker, Hon. David M.:	
Testimony	17
Prepared Statement	44

APPENDIX

Post-Hearing Questions and Responses for the Record from:	
Hon. John Potter	103
Hon. David Walker	117

ADDITIONAL MATERIALS SUBMITTED FOR THE RECORD

American Business Media	137
ADVO, Inc.	138
Alliance of Nonprofit Mailers	142
American Forest & Paper Association (AF&PA)	144
Americans for Tax Reform	147
Amercian Postal Workers Union, AFL–CIO (APWU)	148
Association of American Publishers, Inc. (AAP)	153
Association for Postal Commerce (PostComm)	158
Association of Priority Mail Users, Inc. (APMU)	180
Association of United States Postal Lessors (AUSPL)	188
Consumer Action	191
Cox Target Media, Inc. and Valpak Direct Marketing Systems, Inc. (Valpak)	193
Direct Marketing Association (The DMA)	203
Envelope Manufacturers Association (EMA)	208
Financial Services Roundtable	213
Free Speech Coalition, Inc. (FSC)	218
Greeting Card Association (GCA)	226
Institute for Research on the Economics of Taxation (IRET)	229
International Paper (IP)	234
Lexington Institute	235
Magazine Publishers of America (MPA)	238
Mail Order Association of America (MOAA)	250
McGraw-Hill Companies, The	253
National Association of Presort Mailers (NAPM)	259

Page
National Farmers Union 263
National League of Postmasters 265
National Star Route Mail Contractors Association 276
National Taxpayers Union (NTU) 280
Parcel Shippers Association (PSA) 282
Pitney Bowes 290
Postal Rate Commission (PRC) 298
Printing Industries of America, Inc. (PIA) 313
Publishers Clearing House 315
Small Business Survival Committee (SBSC) 317
Spencer Press Inc 326
Time Warner, Inc. 327

THE REPORT OF THE PRESIDENTIAL COMMISSION ON THE U.S. POSTAL SERVICE: PRESERVING ACCESS AND AFFORDABILITY

WEDNESDAY, NOVEMBER 5, 2003

U.S. SENATE,
COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Committee met, pursuant to notice, at 2 p.m., in room SD–342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Stevens, Akaka, Carper, and Pryor.

OPENING STATEMENT OF SENATOR COLLINS

Chairman COLLINS. The Committee will come to order.

Good afternoon. Today marks the second in a series of hearings that the Governmental Affairs Committee will hold to review the reforms recommended by the Presidential Commission on the Postal Service.

At our first hearing in September the Committee heard from the Commission's Co-Chair Jim Johnson, who outlined the rationale behind the Committee's recommendations.

Commissioner Johnson also made the very important point that although the Postal Service will end this fiscal year with a net income of more than $4 billion, reduced debt, and a smaller workforce, Congress cannot ignore the fundamental reality that the Postal Service is an institution in serious jeopardy.

The Commission presented its assessment in stark terms. It said, "an incremental approach to Postal Service reform will yield too little, too late given the enterprise's bleak fiscal outlook, the depth of current debt and unfunded obligations, the downward trend in First-Class mail volumes, and the limited potential of its legacy postal network that was built for a bygone era."

That is a very strong conclusion and one that challenges both the Postal Service itself and the Congress to embrace far-reaching reforms.

I have long been a supporter of having an independent commission take a look at the Postal Service, and I want to commend the Commission for its very thorough review.

The financial and operational problems confronting the Postal Service are indeed serious. At present, the Postal Service is paying down $7 billion in debt to the Treasury and its long-term liabilities are enormous, to the tune of nearly $6 billion for workers com-

pensation claims, $5 billion for retirement costs, and perhaps as much as $45 billion to cover retiree health care costs.

Last year, when the Office of Personnel Management discovered that the Postal Service was paying too much into the Civil Service Retirement System fund, I joined with my colleague, Senator Carper, in introducing legislation, which was also co-sponsored by Senator Akaka and others on this Committee, to correct the funding problem. This means that the Postal Service was able to delay its next rate increase until 2006 and move aggressively to pay down billions of dollars in debt owed to the U.S. Treasury.

There are other issues with that legislation, however, involving an escrow account which we will discuss today.

Despite the reprieve afforded the Postal Service by the Collins-Carper bill, many problems remain and they have a significant economic impact. The Postal Service itself has more than 750,000 career employees. But 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, and paper manufacturing. The health of the Postal Service is essential to the continued vitality of thousands of companies and the millions of Americans they employ.

One of the greatest challenges for the Postal Service is the decrease in First-Class mail volume as business communications, bills, and payments move more and more to the Internet. This is highly significant, given that First-Class mail accounts for 48 percent of total mail volume and the revenue it generates pays for more than two-thirds of the Postal Service's institutional costs.

The Postal Service also faces the difficult task of trying to cut costs from its nationwide infrastructure and transportation network at a time when carriers must still deliver 6 days a week and the number of addresses served has only continued to grow.

In many ways the work of the Commission builds upon actions already undertaken by the Postal Service. The Senate took the advice of the Comptroller General and requested that the Postmaster General deliver to Congress in April 2002 a comprehensive transformation plan. The Postal Service, in its plan, determined what changes could be made within existing constraints that would result in improved operations, performances and finances.

The transformation plan has been recognized as a very positive first step but that is exactly what it is, a first step. Without legislation many of the necessary reforms highlighted in the Commission's report simply cannot happen.

As a Senator representing a largely rural State whose citizens depend heavily on the Postal Service, I appreciate the 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 my constituents, whether they live in the Northern Woods or on the islands off our coast, or in our many small rural communities have the same access to quality postal services as the people of our cities. Most commercial enterprises would find it uneconomical, if not impossible, to deliver mail and packages to rural Americans at the rates that the postal service offers. So the preservation of universal service is my top priority.

Nevertheless, the Postal Service has reached a critical juncture. It is time for a thorough evaluation of its operations and requirements. It is time for action.

Senator Carper and I have committed to working together with other interested Members of this Committee to draft a bipartisan postal reform bill. Now, given the history of previous attempts to pass postal reform legislation, I recognize that this is a daunting challenge. But it is essential that we seize the opportunity presented by the Commission's report, supplemented by the transformation plan, to build on the excellent work already underway and to complete the job.

I am going to submit the rest of my statement and my full statement in the record. We are expecting, unfortunately, to have three back-to-back votes at 2:30. So I am eager to hear Senator Akaka's remarks and then hear from our two excellent witnesses today, Postmaster General Jack Potter, and Comptroller General David Walker. Both of them have considerable insights that will be very helpful to the Committee.

[The prepared opening statement of Senator Collins follows:]

PREPARED OPENING STATEMENT OF SENATOR COLLINS

Today marks the second in a series of hearings the Committee will hold to review the reforms recommended by the Presidential Commission on the Postal Service. At our first hearing in September, the Committee heard from Commission Co-Chair Jim Johnson. His testimony provided Committee members with the rationale behind the recommendations. Commissioner Johnson also made the very important point that although the Postal Service will end this fiscal year with net income of more than $4 billion, reduced debt, and a smaller workforce, Congress cannot ignore the fundamental reality that the Postal Service is an institution in serious jeopardy. The Commission presented its assessment in stark terms, and I quote, "an incremental approach to Postal Service reform will yield too little, too late, given the enterprise's bleak fiscal outlook, the depth of current debt and unfunded obligations, the downward trend in First-Class mail volumes and the limited potential of its legacy postal network that was built for a bygone era." That is a very strong statement, and one that challenges both the Postal Service and Congress to embrace far-reaching reforms.

From the outset, I have been a strong proponent of the Commission. In the Summer of 2002, I introduced my own bill to establish a Presidential Postal Commission charged with examining the problems the Postal Service faces, and with developing specific legislative and administrative proposals that Congress and the Postal Service could implement. Naturally, I was pleased to have such a Commission issue this type of report just one year later. Under the effective leadership of Co-Chairs Harry Pearce and James Johnson, the Commission put together a highly comprehensive report on an extremely complex issue—identifying the operational, structural, and financial challenges facing the U.S. Postal Service.

To the relief of many, including myself, the Commission did not recommend privatization of the Postal Service. Instead, the Commission worked toward finding a way for the Postal Service to do, as Mr. Johnson described it to me, "an overwhelmingly better job under the same general structure." The Commission's recommendations are designed to help this 225-year-old Service remain viable through at least the next two decades.

The financial and operational problems confronting the Postal Service are serious. At present, the Postal Service is paying down $7 billion in debt to the U.S. Treasury, and its long-term liabilities are enormous—to the tune of nearly $6 billion for Workers' Compensation claims, $5 billion for retirement costs, and perhaps as much as $45 billion to cover retiree health care costs.

In an unexpected turn of events, last year the Office of Personnel Management discovered that if postal payments into the Civil Service Retirement System Fund were to continue on the basis required under existing law, the Postal Service would over-fund its estimated retirement liability by approximately $71 billion dollars over a period of 60 years. In February, Senator Carper and I introduced legislation to correct this funding problem. That bill's enactment this past April enabled the Post-

al Service to delay its next rate increase until 2006 and to more aggressively pay down billions in debt owed to the U.S. Treasury. The bill also required the Postal Service to submit to Congress a proposal regarding the use of the "savings" resulting from the Act, beginning in 2006. Those "savings" would be placed in an escrow account and may not be spent until a pending plan is approved and authorized by Congress. It is my intention to address this issue as part of an overall postal reform bill.

Despite the reprieve afforded the Postal Service by the Collins-Carper bill, many problems remain, and they have a significant economic impact. The Postal Service itself has more than 750,000 career 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, and paper manufacturing. The health of the Postal Service is essential to the vitality of thousands of companies and the millions that they employ.

One of the greatest challenges for the Postal Service is the decrease in mail volume as business communications, bills and payments move more and more to the Internet. The Postal Service has faced declining volumes of First-Class mail for the past 4 years. This is highly significant, given that First-Class mail accounts for 48 percent of total mail volume, and the revenue it generates pays for more than two-thirds of the Postal Service's institutional costs.

The Postal Service also faces the difficult task of trying to cut costs from its nationwide infrastructure and transportation network. These costs are difficult to cut. Even though volumes may be decreasing, carriers must still deliver 6 days a week to more than 139 million addresses.

In many ways, the work of the Commission builds upon work already started by the Postal Service. In late 2001, the Senate took the advice of Comptroller General David Walker and requested that Postmaster General Jack Potter deliver to Congress, in April of 2002, a comprehensive Transformation Plan designed, and again I quote, "to ensure the continuation of affordable universal service and to prepare the organization for the challenges of change in a dynamic marketplace."

In the Transformation Plan, the Postal Service determined what changes could be made, within existing constraints, that would result in improved operations, performance and finances. This plan has been widely recognized as a good "first step," but that's exactly what it is—a first step. Without legislation, many of the necessary reforms highlighted in the Commission's report simply will not happen.

As a Senator representing a largely rural State whose citizens depend on the Postal Service, I appreciate the 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 my constituents living in the northern woods, or on islands, or in our many rural small towns, have the same access to postal services as the people of our cities. If the Postal Service were no longer to provide universal service and deliver mail to every customer, the affordable communication link upon which many Americans rely would be jeopardized. Most commercial enterprises would find it uneconomical, if not impossible, to deliver mail and packages to rural Americans at rates that the Postal Service has been offering.

The preservation of universal service, and many more issues, must be examined in depth if we are to save and strengthen this vital service upon which so many Americans rely for communication and their livelihoods. The Postal Service has reached a critical juncture. It is time for a thorough evaluation of the Postal Service's operations and requirements. It is time for action.

Senator Carper and I have committed to work together with other interested members to draft a bi-partisan postal reform bill. Given the history of previous attempts at legislative reforms, I know this will be a challenging goal, but it is essential that we seize the opportunity provided by the Commission' excellent work.

I welcome our witnesses today, Postmaster General Jack Potter and Comptroller General David Walker, and look forward to hearing their views and insights on the recommendations of the Presidential Commission on the Postal Service.

Chairman COLLINS. Senator Akaka.

OPENING STATEMENT OF SENATOR AKAKA

Senator AKAKA. Thank you, very much, Chairman Collins.

I want you to know, it is indeed an honor and a pleasure and privilege to serve as your Ranking Member today. And I want to add my welcome to our two distinguished witnesses. I also want to

commend our panelists for their focused attention, determination, and passion on what I consider a key public policy issue, which is how to modernize and sustain the U.S. Postal Service.

And I want to add that both of you are such pleasant people to work with and I look forward to working with you in the future.

Even before the Presidential Postal Commission was convened, GAO warned that the long-term financial outlook of the Postal Service was at risk without significant changes. At this Committee's request, the Service developed a transformation plan that offered its vision for the future. The U.S. economy depends on a strong and viable Postal Service, which anchors a $900 billion mailing industry that generates 8 percent of our gross domestic product.

Nor can we ignore that, for many Americans, the Postal Service is their only contact with the Federal Government. The delivery of mail 6 days a week at an affordable rate is an essential service and a critical lifeline for many citizens living in the rural areas or States like Hawaii and Alaska. The good news is that productivity is up, overnight performance is at its highest level, and over 93 percent of consumers are satisfied with their service.

However, the continued decline in First-Class mail is just one reminder that the long-term stability of the Postal Service remains at risk.

This Committee understands and appreciates the challenges facing the Postal Service. It is in this spirit that I look forward to discussing the Commission's recommendations with both Postmaster General Potter and Comptroller General Walker. Although we may disagree on some of the recommendations, I am hopeful that our common goal of guaranteeing the future of the Postal Service will bridge any chasm.

I will work with our Chairman on bipartisan legislation that will preserve universal service at an affordable price and honor the Postal Service's commitments to its employees and retirees.

Thank you very much, Chairman Collins.

Chairman COLLINS. Thank you, Senator Akaka, it is always a great pleasure to have you serve as the Ranking Member of the Committee. Senator Stevens.

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Thank you very much. I just came in in time. It is nice to see you, Mr. Postmaster General. We are working on a few matters around here, non-controversial of course.

Madam Chairman, I am here today to commend Postmaster General Jack Potter for his efforts which have guided the Postal Service now since June 1, 2001. He took on great responsibility when he agreed to become the 72nd Postmaster General of United States and has helped us develop and institute a transformation plan for the Postal Service. His leadership has facilitated increased productivity and has improved customer satisfaction.

I understand the purpose of this hearing is to comment on and evaluate the recommendations made by the President's Commission on the U.S. Postal Service. The Commission also took on great responsibility when they agreed to study the Postal Service and provide these recommendations to improve it.

Although I believe further reform of the Postal Service is necessary, it is my belief that many aspects of the existing Postal Service should be preserved. I was pleased to hear and read that the Commission and the Postmaster General have pledged their commitment to preserve universal mail service throughout the United States.

For my State of Alaska, the concept of universal service is absolutely essential. Alaska does not have access to the infrastructure found in what we call the lower Forty-Eight. For many Alaskans the mail service is a lifeline. We do not use roads. We only travel by air primarily. We have one railroad that goes north to south. But each day it is the Postal Service that delivers 2 million pieces of mail to Alaskan homes and businesses, including vital products that would otherwise not be available in the bush of Alaska.

I remember one time, John, when one of my constituents figured out how to get hay. He just mailed it and put a postage stamp on it. And he just had to fly planes for each 1,000 pounds, that is all.

The services you provide through the Postal Service reach every home and business in America and are essential to American commerce and society.

The Commission's report also provided a comprehensive evaluation of the Postal Service's workforce, operation, leadership, and financial outlook. The President's Commission made several recommendations to reduce the Postal Service's outstanding debt. One recommendation suggests that the Treasury Department should be obligated to fund the cost of CSRS benefits that current and former Postal Service employees have earned through military service. I also believe that the Postal Service should not be responsible for financing military pension benefits. If the Postal Service was required to pay the military portion of CSRS benefits, the Postal Service would be the only Federal Agency required to pay such costs.

In the early 1970's I, along with several other Senators, joined together to create the Postal Service out of the old Post Office Department. And in 1971, President Nixon signed into law the Postal Reorganization Act. In the years which have gone by since the Postal Reorganization Act was originally adopted, technological advances coupled with the financial state of the Postal Service have demonstrated the need for more postal modernization. All recommendations made by the President's Commission should be closely scrutinized and assessed, I think, by every Member of this Committee to ensure the future vitality of the Postal Service.

I am committed to working with you, Madam Chairman, on the Postal Service. I think labor unions, other Members of Congress, and all who helped create this legislation to reform the Postal Service and ensure the core of the mission of the Postal Service is preserved, need to work together.

I thank you, Madam Chairman, for holding this hearing. I do have some questions I would like to leave behind. We are in the middle of a conference. But as I said in the beginning, the Postal Service is in good hands. And I am most pleased to be able to work with you, John. He is a fishing buddy now, so it is a first name. Once you are a fishing buddy you are on a first-name basis up my way.

I am very serious. I have now served on this Committee longer than any member in history and I am very proud of my relationship with the Postal Service and with those who have held your position. It is a very vital necessity in rural America in particular. Be assured that we will maintain what the Constitution dreamed of, which was a universal service of mail delivery to all Americans as long as it is needed.

I congratulate you and thank you very much for your help, my friend. Thank you, I have to go back to my conference.

Chairman COLLINS. Thank you, Senator Stevens. We are very honored to have your insights, given your long association with the Postal Service. Thank you.

Senator Carper, now during my opening statement, I pledged that we are going to solve this problem. So do not say anything that undercuts that, since you were not here to hear what I pledged that you were going to do.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. I always try to live up to your pledges for me and will continue to do that.

My family and I went up on vacation to Alaska in August and went fishing on the Kenai River. I do not know, General Potter, if you went fishing there with Chairman Stevens, but that is a great place to fish. We spent a night in a lodge. They had pictures of all kinds of people up on the wall who had been fishing there on the Kenai and had done pretty well. I think they had more pictures of him than anyone else—there were hundreds of pictures of him, a lot of pictures of him. He is a fellow who knows how to catch fish.

He also knew 32 years ago how to create the Postal Service out of the old Post Office Department. The Postal Service has endured for a long, long time and has served our country well.

Senator Akaka and Senator Collins, the idea that any of us could create a legacy, something as important as the Postal Service, that would stand for over three decades, with relatively little change is, I think, remarkable.

In 1971, though, a lot was different than it is now. In 1971, I was over in Southeast Asia in the Navy and we did not have E-mail. We did not have the ability to pick up a cell phone and talk to people on the other side of the world. We wrote letters, sent them first class. We did not have direct deposit for our checks. There is just a whole lot that is different today than it was then and it impacts on the Postal Service.

What is incumbent on us, I think, is to build on the legacy really that Senator Stevens has provided for us, to stand on the shoulders of those who came before. And they are, as it turns out, pretty broad shoulders.

I think we are fortunate, as we try to figure what kind of Postal Service we want to have in the first half of the 21st Century, to have a Chairman of this Committee who understands the issues as well as she does and is interested in working with folks on her side and our side. I am delighted to have a chance to work with my friend, Senator Akaka.

I think the sun, the moon, and the stars may be in alignment here. There is a realization on the part of the people in this coun-

try, certainly the people who are served by the Postal Service, that maybe it is time to change some things and to modify the way we operate.

There is also a realization that coming out of the legislation I introduced last year, what Congressman McHugh and others have introduced in the House, out of the recommendations of the Postal Commission itself, there is a fair amount of convergence of opinion in what we should do. And that gives us, I think, another reason to be hopeful that maybe in 2004 we will be able to make great progress and end up with a Postal Service that not only stands the test in 2004 and 2005 but for a whole lot longer.

Madam Chairman, I have a statement I would like to enter into the record, if I could.

Chairman COLLINS. Without objection.

[The prepared statement of Senator Carper follows:]

PREPARED OPENING STATEMENT OF SENATOR CARPER

Thank you, Madam Chairman, for holding this important series of hearings on the report from the President's Commission on the United States Postal Service.

By all accounts, the Postal Service has been a success. It receives virtually no taxpayer support and the service its hundreds of thousands of employees provide to every American nearly every day is second to none. More than 30 years after its birth, the Postal Service is a key part of the nation's economy, delivering to more than 100 million addresses and supporting a massive mailing industry.

Thirty years of success, however, does not mean postal reform will be easy. Now is not the time to tinker with the current system in hopes that mail volume will recover or that cost-cutting will buy the Postal Service a few more years.

As my colleagues are aware, mail volume has not been what we'd like it to be in recent years. In fact, many observers believe that First Class Mail, the Postal Service's largest and most important product, has been in decline since the 1980's. The Postal Service itself estimates that advertising mail could overtake First Class Mail as the Postal Service's leading product less than 2 years from now.

At the same time that First Class Mail is on the decline, the Postal Service continues to add nearly two million new delivery points each year. This creates the need for new routes, more letter carriers and new postal facilities. As more and more customers turn to electronic forms of communication, however, letter carriers will likely bring fewer and fewer pieces of mail to each address they serve. The rate increases that will be needed to maintain the Postal Service's current infrastructure, to finance retirement obligations to its current employees, and to pay for new letter carriers and new facilities will only further erode mail volume.

The Postal Service has been trying to improve on its own. They are making progress but there is only so much they can do. Now is the time for Congress to step in.

In order to ensure that the Postal Service is as successful in the 21st Century as it was in the final years of the 20th, we will need to make fundamental changes to the way it operates. Fortunately, there is probably general agreement on about what 90 percent of those changes should be.

Congress has been at work on postal reform for nearly a decade now, mostly in the House. The work done in the House influenced the postal reform legislation I introduced earlier this year—S. 1285, the Postal Accountability and Enhancement Act. I was pleased to learn this summer that the final recommendations from the President's commission on the Postal Service were very similar to that bill in a number of respects.

Like my bill, the commission's final report calls for the preservation of universal service and the Postal Service's monopoly over the mailbox. The commission also recommends, like I do, turning the Postal Service's Board of Governors into a stronger, more independent body that would be better able to manage a business the size of the Postal Service. Both my bill and the commission's report would also give the Postal Service significant pricing flexibility and turn the Postal Rate Commission into a stronger regulatory body. They would also streamline the Postal Service's physical infrastructure and encourage them to adopt new technology that would improve productivity and add value to their products.

We began the process of postal reform at the beginning of this year with the successful passage of the Postal Civil Service Retirement System Funding Reform Act, which I joined Senator Collins in introducing. That bill has given mailers a break from rate increases. It has also allowed the Postal Service to run a surplus this year. The facts show, however, that this situation will not last. We have a brief window now to get real postal reform done. I hope that these hearings we are holding begin the process of working out bipartisan postal reform legislation that we can pass in the first few months of next year.

Senator CARPER. I really look forward to working with you and Senator Akaka and other colleagues. And General Potter, you and your team on the management side, the labor side, the rank and file, we are proud of the work that you are doing, and grateful for the work that you are doing.

I do not know if there is anybody here representing the Commission today, I suspect there is, and we are grateful for the fine work that you have done, your willingness to talk with us, and to receive broad input and we look forward to hearing from our Comptroller General, as well, and others who are going to be testifying.

Thanks very much.

Chairman COLLINS. Thank you very much. It is now my pleasure to call on Senator Pryor.

OPENING STATEMENT OF SENATOR PRYOR

Senator PRYOR. Thank you, Madam Chairman.

I want to thank you for your leadership and Senator Carper and others for your leadership. I know recently you guided us to the successful passage of the Postal Civil Service Retirement System Funding Act of 2003 and I think that was an important step for the Postal Service.

Also, I think now, as we look at what we are talking about today, we understand there are lots of challenges that the Post Office is facing. I think that most Senators I have talked to want to make sure that we keep the word service in mind with Postal Service, that we are serving the people of this country in the ways that we feel like it was designed to do.

But also, we need to look at possible administrative changes and we need to certainly consider postal workers, but other factors in how we modernize our postal system and make it more efficient, but also to meet the challenges that lay ahead.

So Senator Collins, Senator Akaka, and Senator Carper, I really look forward to working with you on this and look forward to today's hearing. Thanks for having it.

Chairman COLLINS. Thank you, Senator.

I would now like to call upon our first witness for the day. It is Postmaster General John Potter. I want to join my colleagues in commending you for your outstanding leadership of the Postal Service during very challenging times.

Since taking the helm as Postmaster General in 2001 you have made great strides in reducing inefficiencies, improving service and productivity, strengthening labor relations, and cutting costs. And I think that is a tribute to how well you know the Postal Service as a 24-year veteran of the Postal Service. You know it inside out. So we are very pleased to have you with us today.

You may proceed.

TESTIMONY OF HON. JOHN E. POTTER,[1] POSTMASTER GENERAL, U.S. POSTAL SERVICE

Mr. POTTER. Good afternoon, Chairman Collins, and thank you for those kind remarks and good afternoon to the Members of the Committee.

I welcome this opportunity to discuss postal legislative reform. My complete prepared testimony has been submitted for the record, so I will keep my remarks brief.

I want to thank the Committee for advancing the notion last year that a President's Commission on the Postal Service might enable legislative change to move forward. The Commission was one of the most important developments during 2003. As Postmaster General, I am grateful for the Commission's efforts. They took on a complex assignment over a short period of time and they did an outstanding job of learning about our business through input from a variety of industry stakeholders. They made difficult decisions in arriving at their final report. We all owe each of the members of the Commission our sincere thanks.

I am pleased that the Commission acknowledged that the Postal Service, through implementation of the transformation plan, is making substantial progress in adapting to an uncertain future. The plan is taking us in the right direction and I appreciate the support of this Committee as we work to create and now execute the plan.

The transformation plan is all about delivering for our customers. To that point, we have brought service and customer satisfaction to historic performance levels. The year 2000 marked the first of a record four straight years of increased total factor productivity. We have reduced our career employee complement by 70,000 from its peak level in 1999. We have delivered $5 billion in cost savings since then. We have established pay for performance systems for managers and executives.

We have also seen, I might add, increases in employee satisfaction as well as a reduction in the backlog of employee grievances awaiting arbitration. In sum, we are aggressively managing the business.

In addition, the recent legislation adjusting our payments to the Civil Service Retirement System, combined with our cost control efforts, will enable us to hold rates steady until 2006. We are particularly grateful for the understanding and cooperation of the Chairman and this Committee for your prompt action in addressing the potential overpayment of the Postal Service pension funds.

The Civil Service Retirement System legislation has contributed to the reduction of outstanding USPS debt by more than one-third from $11.1 billion to $7.3 billion this year. At the same time, the legislation presents very definite challenges. First it shifts the responsibility for funding CSRS retirement benefits earned by postal employees for time served in the military from the Treasury to the Postal Service. GAO estimates this transferred an obligation of more than $27 billion from taxpayers to postal ratepayers. These costs for other Federal departments and agencies continue to be paid by the Treasury. The Postal Service is the only exception.

[1] The prepared statement of Mr. Potter appears in the Appendix on page 27.

We agree with the recommendation of the President's Commission that the Postal Service should not be responsible for military service cost. The CSRS legislation also asks the Postal Service for proposals regarding the use of savings resulting from the Act beginning in 2006. Those savings are to be placed in an escrow account pending Congressional authorization of how they will be used. For 2003 and 2004 there are actual funds available, savings, to use for other purposes and we will use those funds to pay down debt. In 2005 those funds will be used for operating expenses and capital investments, allowing us to extend the rate cycle.

We are doing everything we can to extend the rate cycle beyond 2005, but we expect that we will have to raise rates in 2006 due to inflationary cost increases.

Should the escrow account or escrow funds not be eliminated, postage rates will have to rise even more than is necessary. Thus, without further legislation, postal customers will find themselves back where they started, reinstating the overfunding the legislation was designed to correct. We have provided our comments on these issues to Congress, the administration, and the GAO, and we hope that you will act on our recommendations.

Many in the Postal Service and the mailing community and Congress have long recognized that our basic business model is outdated and lacks flexibility. The stellar service performance and $3.9 billion net income projected for fiscal year 2003 should not deter us from moving forward with legislative reforms. Besides, about $3 billion of the $3.9 billion positive net income is due to the CSRS legislation. The reality is that mail volume declined in each of the last 3 fiscal years, dropping nearly 6 billion pieces overall. During the same 3-year period, the number of addresses we serve increased by 5.2 million.

The President's Commission recognized that electronic media threatens First-Class mail and the Postal Service's long-term success. The Commission also understood the need to act before a crisis imposes hardships on the American public, American businesses, or on postal employees.

We accept most of the Commission's views and are working to implement those where we can. For example, we are enhancing our financial reporting, transitioning to Securities and Exchange Commission requirements where those requirements make sense when applied to a non-stockholder owned company. We support the Commission's recommendation that the Postal Service requires additional flexibility to manage, especially when it comes to rate-making.

Let me assure you that the Postal Service is committed to the collective bargaining process and continually seeks to enhance its relationship with our employees. We have demonstrated our preference for negotiated settlements and seek to avoid the use of arbitrators to settle our disputes. In the event the parties reach impasse, we agree with the Commission that the collective bargaining process could be enhanced with a mandatory mediation step providing another opportunity for settlement prior to arbitration.

It is our intention to negotiate with each of our unions to add mediation to the current process. In addition, collective bargaining

should give all parties the ability to negotiate for benefits as well as wages.

And let me assure you again though, it is not our intention to reduce the benefits already enjoyed by current and retired employees.

In short, on many key issues, the Commission and management have a basic level of agreement. There are, however, some areas where we have reservations.

As an example, in the area of governance, the Commission recommends significant changes to our governing board. The Governors of the Postal Service are today appointed by the President with the advice and consent of the Senate. The law requires that no more than five may belong to the same political party. This has allowed the Postal Service to enjoy bipartisan oversight for the last three decades. The Commission's proposed new board of directors could change this. In addition, the Commission proposes a 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.

For instance, the Postal Regulatory Board can revisit the vital national issue of postal monopoly and universal service. From the perspective of the Postal Service, these are clearly issues of broad public policy. They are not regulatory issues. Without the fine 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 regulatory board could also affect the outcome of the collective bargaining process. They could define the range within which wages may be negotiated. They would also be charged with making a wage comparability determination. This, too, is something that should be part of the collective bargaining process. Under the proposals of the Commission, the powers given to a regulatory board would essentially destroy meaningful collective bargaining. We do not think that it is in the Nation's best interests.

When considering the role of a regulator, there should be a clear line between what is appropriately a management function with board oversight, regulatory function, and that which is public policy reserved for the Nation's lawmakers.

I am encouraged by the interest of this Committee and the interest that you have demonstrated by holding a series of hearings to explore the recommendations of the President's Commission on the Postal Service. The Commission has added a new voice to the important conversation about the future of America's mail system.

Chairman Collins, I have been asked on many occasions for my vision of the Postal Service's future. In my opinion, America needs a Postal Service that has an incentive to improve service and productivity, a Postal Service that is given the flexibility to reduce costs, a Postal Service that can implement rates that are responsive to the market and that will mitigate large counterproductive rate increases.

America also needs a Postal Service that has the ability to work with and treat customers as individuals with individual needs,

where our products, services, and systems are available to those customers where they are located, not just where post offices are.

And finally and most importantly, America needs a Postal Service that can retain a motivated and informed workforce to provide universal service to every home and business in the Nation.

Thank you, Madam Chairman and I will be happy to answer any questions.

Chairman COLLINS. Thank you very much, Mr. Potter.

You outlined some areas where you believe the Commission's recommendations should be altered. Could you tell us what you view to be the most important recommendation of the Commission as far as ensuring the long-term viability and strength of the Postal Service?

Mr. POTTER. I think there are two areas that the Commission focused on that I think are helpful to the Postal Service. The first is the area of rates and the need to change the rate system so that we can manage that process better than we have in the past.

In addition to that, I think the other area of focus is the notion that management has the ability to control its costs through the network of post offices and processing centers throughout the country, through which we deliver service to America.

Chairman COLLINS. Thank you.

The Postal Service has recently reported, and you said in your testimony today, that it has reduced the workforce by some 70,000 over the past 5 years. I want to commend you for the way in which you have done this. I think that it has been done in a way that has avoided disruption to service and to the lives of the individual employees involved by placing a great reliance on attrition or early retirement programs, even those without particular financial incentives.

At the Committee's hearing in September, Commissioner Johnson noted that by the year 2010 approximately 47 percent of the Postal Service's workforce, the career workforce, will be eligible for retirement. Does this offer an opportunity for you to right-size the organization without resorting to widespread layoffs that would obviously be painful for the employees involved?

Mr. POTTER. We have committed to our unions that we would not lay people off. In fact, we have signed contracts with two of our unions a year in advance of their expiring. The reason we did that was to address the concerns of our employees that we had plans to lay people off.

I believe that the level of attrition that we anticipate happening over the next decade is sufficient to handle any restructuring that might occur within the Postal Service. And I do not believe we are going to have to resort to layoffs.

Chairman COLLINS. One of the recommendations made by the Commission was that the pension and other benefits of postal employees should be made a matter of collective bargaining. I believe you endorsed that recommendation today but I just wanted to clarify that for the record.

Mr. POTTER. I endorsed that recommendation, particularly for new hires. But I believe that we have a contract with our current employees and those who have retired from the Postal Service and

I do not believe that those changes should occur other than through collective bargaining.

Chairman COLLINS. The Commission made some controversial recommendations, in terms of creating an independent commission that would look at the capacity of the Postal Service, particularly your mail processing centers. It would be modeled on a base closure commission. Some of us who have experience with base closure commissions do not have positive feelings about that process.

I wondered if you could share with us whether you think that we need to create a base closure-like commission to review the structure of the Postal Service, the infrastructure of the Postal Service, or whether you think that there is a better way to identify excess capacity to the extent it exists?

Mr. POTTER. The Postal Service has been evolving for over 200 years. In the past 2 years alone we have modified our network. We have closed over 50 facilities. I think that evolution will continue to take place. I personally think that the expertise to make decisions about which facilities are necessary and which are not rests within the Postal Service. I think we are the best experts in the world when it comes to mail and we know what opportunities exist.

The other thing about the Postal Service is we are everywhere and we intend to stay everywhere. When it comes to making decisions about networks and facilities, these really are local issues, in a sense they are metropolitan issues. And I believe they need to be dealt with by postal management at the local level and the communities, politicians, employees in that local area.

So I think that the value of a national commission is questionable. It may help but I think we would have to see further details about how they might approach this issue which I believe for the most part are local in the sense that they deal with metropolitan issues and not national issues.

Chairman COLLINS. Thank you. Senator Akaka.

Senator AKAKA. Thank you very much, Madam Chairman.

Thank you for your testimony, Mr. Potter. I want to add to what I said earlier in my statement. You have been the right man in the right place at the right time since you were named the Nation's 72nd Postmaster General. Again, it is a pleasure to work with you and I look forward to that.

Mr. Potter, you spoke of the need to shift the obligation to cover military retirement costs of postal employees back to the Treasury from the Postal Service. This shift is supported by the President's Commission. I understand that the resulting savings would be used to fund future retiree health benefits.

I am curious why the Postal Service did not oppose the requirement that it cover military service payments when Congress was considering the CSRS legislation. Would you please comment on that?

Mr. POTTER. At the time that the legislation was drafted, it had a clause that asked for later comment. So we chose to follow that path, get the benefits that we could, and deal with that issue as outlined in the legislation at future hearings like this and in future legislation that dealt with the escrow account.

Senator AKAKA. Thank you. The Commission recommends providing the proposed Postal Regulatory Board with a number of new

authorities including defining universal service and the mail monopoly, setting revenue requirements, and studying wage comparability. A great deal of this tracks legislation considered by the House of Representatives last year which the Postal Service supported.

My question to you is will you support similar provisions in the future?

Mr. POTTER. What we did last year, we supported a comprehensive legislative bill. We did not necessarily support every item in that bill. And I think we are pretty clear on our feelings about the role of the regulator, the role that management should play, and we feel that we should have the ability to manage our networks, our systems, our people. And we believe that the Congress should have a role when it comes to defining universal service and outlining for the Postal Service what our obligations are to the American public.

Senator AKAKA. My final question, and I appreciate your responses to my other questions, Mr. Potter.

The Commission recommends using the Postal Service's core strength, the first mile and the last mile. United Parcel Service recently announced a test program utilizing the Postal Service for deliveries to homes in some rural areas. Does this relationship require any special contractual arrangement with UPS governing the handling of items that UPS gives to the Postal Service for delivery?

Mr. POTTER. No, UPS is accessing a rate, a parcel select rate, where they deposit mail at a delivery unit and we carry it the last leg to the customer's door. So they are simply accessing an existing postal rate. It is not an exclusive rate. Anybody in America can access that rate and we hope that all package companies use us for the last mile.

Senator AKAKA. Thank you, Madam Chairman.

Chairman COLLINS. Thank you very much, Senator. I would inform everyone that there are about 6 minutes left in this vote. My hope is we could get through some questions—unfortunately we have three votes back to back—and then take a 20-minute recess, and then go on to our second witness. Senator Carper.

Senator CARPER. Mr. Postmaster General, Senator Collins asked a question relating to a BRAC-like procedure to address the issue of identifying post offices that might be candidates for realignment, for closure, or whatever. Let me ask a variation of that question, but one that focuses more on processing centers, distribution centers, that kind of thing.

I know that the Postal Service is taking steps to close or make other changes in its processing centers across the country. I think it was announced in September that three—I think you call them remote encoding centers—I think one was in Kentucky and maybe another in New York—but three centers would be closed by early next year.

In Delaware, as you know, there are a number of changes that have been made. We only have one processing/distribution center, just south of Wilmington. Those changes have resulted in some work moving up to Philadelphia where I am told they are planning to build a very large new processing center close to the Philadel-

phia airport, which as it turns out is closer to my home than it is to the home of the mayor of Philadelphia.

I am sure that similar changes have been reported across the country. I guess my question is is there some strategy behind what the Postal Service is doing with its processing facilities? And if there is, could you share that with us today?

Mr. POTTER. As I said earlier, the Postal Service has evolved over the years. At one point in our history we had 74,000 post offices and over 1,000 places that processed originating mail and acted as plants. Over the course of time, deployment of equipment, first mechanized equipment and now automated equipment, has enabled the Postal Service to consolidate the processing of that mail. As I said earlier, we are constantly looking at our networks to determine where and how we can efficiently process mail.

So the examination or the discussion of the network and what alternatives might exist to make the network more efficient, while delivering better service, has been something that we have been participating in for 25 years. So I consider it to be again part of the evolution of the Postal Service.

Senator CARPER. Do I gather from that that there is no strategy behind what you are doing in this area?

Mr. POTTER. The strategy is to become efficient, provide high levels of service, to accommodate employees as best we can through the contract to make this network more and more efficient. That is the basic concept of what we are doing and it is something that is part and parcel with the Postal Service and it has been part and parcel at the Postal Service for at least the 25 years I have been at it.

Senator CARPER. When you look at what the Commission is recommending, and maybe consider the legislation that I introduced earlier this year, and what you are trying to do in terms of bringing the Postal Service into the 21st Century, the discussions you had with organized labor and your customers, what would you pick out as just a handful of the toughest issues that we face as we take up early next year the issues of postal reform?

Mr. POTTER. I think one of the toughest issues that any postal administration has faced throughout the world is this notion of how you provide access to postal services. And whether that is a brick and mortar post office versus a rural carrier, which we have, a post office on wheels. People like their post office and the notion that there are other ways of providing that service other than through brick and mortar is something that all postal administration's around the world struggle with. So that is something that I believe we will struggle with as well.

The notion of the role of a regulator, we recognize that there will be a regulator. The question is what is appropriate for the regulator to do, what is appropriate to allow management to do with oversight by the presidentially appointed board. That is a tough decision. What should you be keeping, in terms of your oversight when it comes to universal service and the monopoly, issues which are very important to your communities. Those are the issues that I think you will probably hear the most debate about and be concerned about.

In addition to that, anytime you deal with labor and labor issues, they are very sensitive and everybody is concerned about the way they are treated as an individual, including me, what your pay, what your benefits are, and what your working conditions are. So anything that would affect that is sensitive.

And those, I think, are the key issues that you will face as you work through legislation. You have done it before. I hope I hit the ones that people have been commenting to you on.

Senator CARPER. Thanks. Madam Chairman, my time has expired, and I think our time has almost expired.

Chairman COLLINS. It has indeed. I want to thank Senator Carper for his questions.

Postmaster General Potter, you are a lucky individual today because this series of votes is going to spare you a second round of questions. So we will excuse you but we will look forward to working closely with you.

The Committee will be in recess for approximately 20 minutes and then we will turn to the Comptroller General. Thank you for being here today.

[Recess.]

Chairman COLLINS. The Committee will come to order.

First of all, let me apologize to our witness and to the members of our audience for the delay. We did have three back to back votes this afternoon, something that was neither anticipated nor scheduled at the time we scheduled this hearing.

I am now pleased to welcome our second witness, U.S. Comptroller General David M. Walker.

As Comptroller General, Mr. Walker is the Nation's chief accountability officer and the head of the U.S. General Accounting Office. Mr. Walker has also been a leader in the effort to review and transform the U.S. Postal Service.

We are very pleased to have you with us today and we appreciate your patience and your insights. You may proceed.

TESTIMONY OF HON. DAVID M. WALKER,[1] COMPTROLLER GENERAL, U.S. GENERAL ACCOUNTING OFFICE (GAO)

Mr. WALKER. Madam Chairman, thank you very much. Senator Carper, it's good to see you again.

I am pleased to be here to participate in this hearing on the President's Commission on the U.S. Postal Service. I would like for my entire statement to be entered into the record, if that is possible, Madam Chairman.

Chairman COLLINS. Without objection.

Mr. WALKER. Thank you. I will move to summarize the key points for your consideration.

I think it is important to note that the U.S. Postal Service has gained some financial breathing room recently as a result of the pension legislation that both of you sponsored and pushed. That legislation resulted in a significant benefit to the Postal Service and its stakeholders within the last year.

At the same point in time, I think it is important to recognize that the Service's long-term financial challenges remain. And ac-

[1] The prepared statement of Mr. Walker appears in the Appendix on page 44.

cordingly, the Service's long-term outlook and transformation effort remains on our high-risk list.

Since we placed the Service on our high-risk list in April 2001, the Service has developed its 2002 transformation plan, cut various costs, and improved its productivity. These are all positive, important steps which Postmaster General Potter ought to be commended for.

At the same point in time, these modest incremental steps cannot resolve the fundamental and systemic issues associated with the Postal Service's current business model. And as you said, Madam Chairman, this is a positive first step but much more needs to be done in order to get us to where we need to be.

With regard to the Commission's report, we believe that the Commission's report provides a valuable contribution to assist the Congress, the Service, the Executive Branch, and the stakeholders in considering the actions needed to transform the Postal Service to a more high performing, results oriented, transparent, sustainable, and accountable organization.

The Commission's recommendations echo many of GAO's prior reports, and address concerns that we have raised in the past. We agree with the Commission that an incremental approach to Postal Service reform will likely yield too little, too late.

We believe that the time has come for Congress to enact comprehensive postal reform legislation that would clarify the Service's mission and role, including defining universal postal service in a 21st Century world, enhance its governance structure, accountability, oversight, and transparency mechanisms, improve regulation of postal rates, and make important human capital reforms.

As noted in my statement, we agree with many of the Commission's recommendations, but have some concerns with regard to certain recommendations. For example, with regard to the basis for appointing certain members of the Board of Governors, the role and responsibilities of the new Postal Regulatory Board, and certain other issues such as negotiated service agreements.

In addition to statutory reform, we agree with the Commission that the Service has many opportunities to become more efficient, notably by standardizing its operations and reducing excess capacity in connection with its network and otherwise. This vision is achievable if approached in a comprehensive, integrated fashion, based upon a strategy and a formal plan. And it is also something that has to be done in conjunction with the various postal stakeholders, both internally and externally, in order to maximize the chance for success.

The impending retirement of much of the Service's workforce provides an opportunity to right-size the organization with minimal disruption. However, the Service has not provided adequate transparency, in our opinion, of its plans to rationalize its infrastructure and workforce, as well as on the status of the initiatives that are outlined in its transformation plan. While incremental progress has been made, more needs to be done. There needs to be more specificity and there needs to be more transparency with regard to these important initiatives, in our view.

To facilitate the Service's progress in implementing actions under the existing system, we recommend that the Postmaster General

develop a comprehensive and integrated plan to optimize its infrastructure and workforce in collaboration with its key stakeholders and to make that plan available to the Congress and the general public.

In addition, the Postmaster General should provide periodic updates to Congress and the public on the status of implementing its transformation initiatives and other Commission recommendations—and also GAO recommendations I might add—that fall within the scope of its existing authority. We believe it is important to have a strategy, to have a plan with key milestones with appropriate transparency and accountability mechanisms.

We also share the Commission's concerns that the Service's funding of its approximate $92 billion in liabilities and other obligations should be a matter of serious concern. Although recent legislation has addressed how the Service will cover its CSRS pension obligations over the next 4 years, the Service continues to make minimum payments for its substantial obligations which are currently financed on a pay-as-you-go basis.

In this regard, in our view, given the legal nature and the economic substance of the Service's retiree health obligations, these costs and related obligations should be accounted for on an accrual basis, not a cash basis. This is an important matter that demands timely attention. This issue also involves $48 billion in discounted present value terms.

We recognize that building accrual base measures for retiree health costs into the current rate base, either through a change in accounting or otherwise, may be difficult considering the pressure to hold down rate and defer rate increases. However, in our view, we believe it is more prudent, appropriate and equitable to address the unfunded obligations in a manner that is fair and balanced to both current and future ratepayers.

At the same time, in our view, consideration should be given to possible transition adjustments for rate setting purposes in connection with any related change in accounting or funding for retiree health benefits.

Basically what is happening right now is they are accounting and building these costs into rates on a pay-as-you-go basis which backloads the cost and puts additional pressure on rate increases in the future, which is a matter of concern given the demographics of the workforce and the competitive posture that the Postal Service faces.

In summary, we and the Commission agree that the Service faces an uncertain future. We also agree that both Congressional action on comprehensive postal reform legislation and additional actions by the Postal Service to make improvements under its existing authority are necessary to ensure the future viability of the Postal Service.

The simple truth is that the Service's current business model is not sustainable in today's competitive environment. Progress has been made, there is no question about it. But in our view, the time has come for both comprehensive postal legislative reform as well as additional administrative actions by the Postal Service to help assure that it can meet the needs of its customers and our country

in the 21st Century. The status quo is not only unsustainable, it is arguably unacceptable.

We look forward to working with the Congress, with both of you, the Postal Service and other stakeholders to address these challenges.

Thank you, Madam Chairman and I would be happy to answer any questions that either one of you might have.

Chairman COLLINS. Thank you very much, Mr. Walker.

I am going to give Senator Carper the opportunity to question first, because I know he has a commitment over on the House side.

Senator CARPER. Thank you so much, Madam Chairman.

General Walker, how are you? Good to see you.

Mr. WALKER. Well, Senator. How are you?

Senator CARPER. I am doing fine.

Thanks so much for being here, and for your help on this and a lot of other things.

It is reported, I think in the Postal Service's last 5-year strategic plan, that the Postal Service will begin delivering more advertising mail than First-Class mail sometime, I want to say before the end of 2005. I just wondered, in your own thoughts, what might this mean for the future of the Postal Service? Will its financial health be even more dependent on the health of the overall economy? Will customers no longer see as much value in the Postal Service if, when they open their mailboxes—as I did last night—and find mostly items that were not First-Class mail but were largely solicitations?

Mr. WALKER. Well, there are a number of issues here, Senator Carper. As you know, First-Class mail covers about 70 percent of the institutional cost of the Postal Service. So to the extent that you have a decline in the volume of First-Class mail, which has occurred in the last couple of years, it is a matter of real concern.

Second, to the extent that volume is increasing in other areas, it can help to offset that concern. However, it depends upon what the nature of the volume is and what alternative delivery mechanisms might be available other than through the mail to deliver that type of advertising, whether it be through the newspaper, whether it be through the Internet, on television, or otherwise, if you will.

It is hard to say what the ultimate impact is going to be. I will tell you this, if I look in my home mailbox, I sort between personal correspondence which is not very frequent in today's world, advertisements, which are of growing volume, and bills which I am not happy to receive but nonetheless I do receive and I must pay on a timely basis.

I think that is one of the issues that is also relevant in defining what is an appropriate definition for universal postal service in the 21st Century. I think it might be different in rural Alaska and rural Maine than it is in urban New York City.

What kinds of things are being delivered? And what is the sense of urgency and the need for frequency with regard to some of these types of things. I think these factors need to be considered as well.

Senator CARPER. Thanks. The President's Commission suggests, I believe, that the new rate system that they call for goes into effect after the completion of one final rate case under the old rules.

Since the outcome of this rate case will serve as really the baseline for all future rate changes under the new system, I am just wondering how can we ensure that the process is not bogged down with the usual disagreements? What steps should we in Congress or the Postal Service or among the regulators, take in order to ensure that the case goes a little bit more smoothly than some of our other rate cases have gone in the past?

Mr. WALKER. Senator, there is no question that there have been concerns expressed by a variety of parties with regard to how long it takes in order to move a rate case, and therefore how far in advance the Postal Service has to begin putting together the necessary filings in order to provide reasonable assurance that they will have the revenues when they need them. I will talk with my very capable staff and see if I can come up with some specific thoughts to provide you for the record, but there is nothing that comes to the forefront of my mind at the present point in time.

Senator CARPER. Thanks very much.

Madam Chairman, you have been mighty gracious to let me go first. I very much appreciate it and look forward to working with you on these issues as we go forward and certainly to working with GAO and John. Thank you.

Chairman COLLINS. Thank you, Senator.

Mr. Walker, the preservation of universal service at affordable rates is my key goal when I look at the Commission's report. One surprising recommendation to me that the Commission made was to allow an independent regulatory body to shape the private express statutes or to make recommendations on whether or not the monopoly on First-Class mail that the Postal Service has, which is so linked to universal service, should be changed.

What is your judgment on that? Do you think that an independent regulatory commission should be making those decisions? Or are those decisions that are more appropriately continued to be vested in the Congress?

Mr. WALKER. As I mentioned before, we had some concerns about the role and responsibilities that the Commission proposed for the Postal Regulatory Board. I think you have to divide these roles and responsibilities into three possible categories. One would be public policy. Another would be regulatory in nature. And a third would be oversight.

I think to the extent that you are dealing with a public policy issue, such as the definition of universal postal service and some of those issues, I think they are properly reserved to the Congress. In this regard, there may be recommendations coming forth by postal management, endorsed hopefully by the Board of Governors, and possibly commented on by this new regulatory body.

But when you are dealing with a major public policy issue, I think those types of decisions need to be made by the Congress.

The real question is, on some of these issues, how do you ensure timely action by the Congress? But when you are dealing with universal service, I think the Congress has to play a role.

Chairman COLLINS. The Commission's report makes many recommendations affecting the postal workforce. One of those is to move toward a pay for performance system. You have had a great deal of experience at GAO in modernizing your personnel system,

including, I believe, incorporating elements of a pay for performance system.

I want to compliment you on how you have proceeded, because you have really involved the employees in designing the system. You have ensured that they are well-trained. And thus, a lot of the changes that you have made have been well regarded and well accepted.

Could you share with us any thoughts based on your experience in transforming the GAO workforce that might apply to the challenges facing the Postal Service?

Mr. WALKER. First, philosophically I am a believer in pay for performance where it makes sense. I might note that at the present point in time about 80 percent of GAO's workforce is on a pay for performance system. It is our objective that 95 percent plus of our workforce will be on a pay for performance system within the next couple of years.

There are certain occupations, however, that we do not propose to put on pay for performance based upon the nature of what their roles and responsibilities are. These are priority wage grade personnel.

So from a philosophical standpoint, I am a believer in pay for performance, where you can end up trying to link institutional goals and objectives with individual performance and to recognize and reward people who can help to contribute towards desired institutional outcomes.

I do, however, believe it is not for everybody. I also believe that you have to be very careful as to how you go about designing any type of pay for performance approach. You have to involve unions. You have to involve employees to the extent that they do not have union representatives. And you have to have their involvement in the very early stages of the process.

You also have to have a modern, effective, and credible, and preferably validated performance appraisal system because the performance appraisal system would be the basis under which a lot of the decisions would be made under a pay for performance approach. You need to have adequate safeguards such as independent reviews, in our case by our Human Capital Office and our Office of Opportunity Inclusiveness, to maximize the chance that it is fairly and consistently applied, and minimize the possibility of abuse or discrimination. You need to have appeal rights that exist, both informally, and through a more formal internal grievance process and independent mechanisms, as appropriate.

You need to recognize that it will take time to design and effectively implement an effective and credible pay for performance system. Frankly, you will need to modify it and continuously improve it over time, based upon actual experience.

So I believe philosophically it has great merit, but I think one has to be very careful about how you approach it.

Chairman COLLINS. Another of the Commission's recommendations was that the Postal Service pension and post retirement health-care plans should be subject to collective bargaining. What is your opinion of that recommendation and what impact do you believe separating out the postal retirement benefits from the rest of

the Federal workforce would have on the overall financial stability and health of the Federal retirement plans?

Mr. WALKER. From a philosophical standpoint, I am a general believer in collective bargaining. And therefore, to the extent that you can subject compensation, all forms of compensation to bargaining, then philosophically I think that is a good thing to do.

Obviously, we do however have to recognize that the Postal Service is a major Federal employer. It is also a major element of the Civil Service Retirement System. You just had legislation to deal with that. It is also a major player in the FEHBP, the Federal Employees Health Benefits Program.

Now candidly, and it is my understanding that a separate accounting and reporting has already been done with regard to the Postal Service on the pension issue, which was the subject of the legislation that you recently passed.

Furthermore, there is a separate accounting that is being done right now at our request and also the Congress' request to look at the retiree health obligations to try to find out whether or not that $48 billion number is a reasonable number or whether or not there are problems associated with it.

It is also my understanding that the Postal Service has the authority right now if they want to pull out of the FEHBP and to have their own plan for active employees as long as they provide a comparable plan.

So I think philosophically it makes sense to consider subjecting this to collective bargaining. I think that there would be clearly similar issues associated with the balance of the Federal Government, but those are not insurmountable obstacles and I think those could be worked through.

Chairman COLLINS. Senator Akaka told me that he was going to be returning to ask questions. I am going to ask his staff to see if they can check on that, so that we can see whether I should continue to question you in order to buy some time for him to return or whether the end is almost in sight for you.

Mr. WALKER. Do I have a vote, Senator?

Chairman COLLINS. Right.

Mr. Walker, you were the leader who first suggested to this Committee that the Postal Service come up with a transformation plan. And the Postal Service did so in April 2002 and has been implementing it. How would you grade the success of the Postal Service in following its own transformation plan at this point?

Mr. WALKER. I would not want to give them a grade. I will, however, say the following. I believe that they have taken it seriously. I believe that they have taken a number of positive steps to begin to implement some of the critical elements of the plan. I believe that the plan needs to provide for more specificity than it does right now. I also believe that there needs to be more transparency with regard to what they are doing and what they have accomplished, and also what they plan to do going forward with regard to the transformation plan, especially in the area of rationalizing infrastructure and workforce modernization.

Chairman COLLINS. The Postal Service has been criticized, despite recent progress that has been made, for having opaque and difficult to follow financial statements. Could you comment on the

issue of the need for more transparency in that area and give us your evaluation of the financial reporting systems that the Postal Service has in place?

Mr. WALKER. First, I think we have to keep in mind that the Postal Service is one of the largest employers in the United States. If it was a Fortune company, it would be a Fortune 10 company. So it is a very large and important enterprise. It is also one that is important not only to its customers but also to our country.

I do not believe that the current amount of financial transparency is adequate. I do believe that the recommendation that the Commission made, and that frankly we have made before, whereby the Postal Service should consider voluntarily complying with the substance—not necessarily the detail—but the substance of the major reporting requirements that apply to large public companies, would be a step in the right direction.

You might note that there is a difference between the number that the Postal Service reported for their preliminary net income estimate for this fiscal year, namely what is in their testimony versus ours. We said $4.2 billion, they said $3.9 billion. That changed within the last 24 hours and we did not find out about it until after we had sent our testimony up to the Hill.

So I think they need to be more transparent and I think that following some of the principles that apply to public companies that relate to SEC reporting would be a step in the right direction.

Chairman COLLINS. You notice that in my statement I picked a number between your two numbers, but you are right. When we are talking about billions of dollars and such a large enterprise, there is a lot more, in my judgment, that I think could be done. And complying with some of the standard SEC-type of reporting requirements, I think, would be a step in the right direction.

Finally, let me ask you is there any recommendation of the Commission that you think is particularly important if we are to ensure the long-term viability of the Postal Service?

Mr. WALKER. There are a number of recommendations that I believe are important, but there are ones that I think are particularly important that are also going to be particularly controversial and difficult. Looking at their mission, what should their scope be, including the issue of universal postal service in the 21st Century. Second, rationalizing their infrastructure. And third, modernizing their workforce policies and practices.

Those, I think, are the three probably most important. They arguably are also the three most complicated and controversial. But I hope that we are going to be able to make progress on these because I think it is essential that we do so in order to achieve an effective transformation.

Chairman COLLINS. I thank you very much not only for your testimony today but for the excellent work that the GAO has done on postal transformation. We look forward to continuing to work very closely with you and your staff as we begin the process of drafting postal reform legislation.

My approach to Senator Akaka's absence, since I know he is delayed on the Floor, is to ask for your cooperation in answering any questions that he might have for the record.

And the hearing record will remain open for 15 days.

I want to thank you very much for being here today. It has been very helpful for the Committee to hear firsthand the views of the Postmaster General and the Comptroller General as we continue with what will be a series of hearings evaluating the Commission's report and other ideas for postal reform. These hearings will continue early next year and we look forward to working with all interested parties.

I also want to thank Ann Fisher on my staff who has spent a great deal of time working on these issues and will continue to do so next year.

Thank you and this hearing is now adjourned.

[Whereupon, at 4:02 p.m., the Committee adjourned.]

APPENDIX

TESTIMONY OF
POSTMASTER GENERAL/CEO
JOHN E. POTTER
BEFORE THE
COMMITTEE ON GOVERNMENTAL AFFAIRS
UNITED STATES SENATE
NOVEMBER 5, 2003

Chairman Collins and members of the Committee, I welcome this opportunity to meet with you today to discuss the important issue of postal, legislative reform. This is a subject that is critical to the continued, long-term ability of the United States Postal Service to provide affordable, universal mail service to every individual, home and business in America.

In particular, I look forward to discussing some of the recommendations of the President's Commission on the United States Postal Service.

As Postmaster General, I am grateful for the Commission's efforts. I am pleased by the Commission's acknowledgement that the Postal Service's Transformation Plan is making substantial progress in adapting to an uncertain future. Since assuming the role of Postmaster General, I have made the Plan the central focus of the Postal Service.

And I am particularly satisfied that so many of the Commission's recommendations are consistent with strategies that we are already pursuing as a part of our transformation efforts. Clearly, the Postal Service's Transformation Plan is taking us in the right direction. And I appreciate the support and guidance of this Committee as the Postal Service worked to create the Plan.

While the Transformation Plan became our organizational vision in 2002, the ongoing process of transformation began long 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. We have reduced our career employee complement by 70,000 from its peak level in 1999. We have delivered $5 billion in cost savings since 2000. We have established pay-for-performance systems for managers and executives. We have brought service and customer satisfaction to historic performance levels. 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 to achieve a welcome and needed level of financial stability.

Without the correction provided by this legislation, the Office of Personnel Management found that the Postal Service could have overpaid its obligation by $105 billion, costs that would otherwise have been borne by every user of the mail through the price of postage. We are particularly grateful for the understanding and cooperation of the Chairman and this Committee for your prompt action in addressing this problem.

By immediately reducing costs related to funding the Civil Service Retirement System, this legislation will allow us to hold rates steady until 2006. This legislation 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. We will continue to take advantage of the new CSRS payment schedule to reduce debt even more this fiscal year.

Yet, the same legislation presents very definite challenges.

First, the legislation shifted the responsibility of funding CSRS retirement benefits earned by postal employees while they served in the military from the Treasury to the Postal Service. The General Accounting Office estimates that this transferred an obligation of more than $27 billion from taxpayers to postal ratepayers. Of this amount, $17 billion represents retroactive payments of funds (including imputed retroactive interest) already provided to annuitants by the Treasury between 1971 and 2002. Except for the Postal Service, in all other cases, these costs continue to be paid through general appropriations. The Postal Service does not receive general appropriations: our operations are funded by the revenue generated by the sale of postal products and services. These military retirement costs have no connection to the operation of the Postal Service or to the services rendered to our customers now and in the future. In fact, more than 90 percent of that financial obligation is the result of military service performed before the Postal Service was created. It includes service in World War II, Korea and Vietnam.

The President's Commission recommends that military service costs not be borne by the Postal Service. We agree with the Commission on this issue, as we indicated in the report which we provided in compliance with your requirement in the reform legislation. We look forward to working with the Committee as you continue your consideration of this issue.

That legislation also asked the Postal Service for its proposals regarding the use of the "savings" resulting from the act, beginning in 2006. Those "savings" would be placed in an escrow account pending Congressional authorization about how they would be used.

I would like to take a moment to explain these "savings." They represent the difference between the Postal Service's new CSRS payment schedule and the old. They represent an adjustment of payments, costs we will not have to pay in the future. But simply because we will not be liable for these costs in the future, does not mean that there will be a reserve of actual cash waiting to be diverted to other purposes. Rather than building cash, the "savings" are used to fund normal inflationary cost increases such as COLA's and general pay adjustments required by collective bargaining agreements, increased health care benefit expenses for employees and annuitants, and growth in non-personnel expenses for fuel, utilities and materials.

For the period from 2003 through 2005, there are actual funds available – savings – to use for other purposes. This is because the postage rates now in effect were computed based on our former, higher CSRS payment schedule. A percentage of the price of every postage stamp has been earmarked for those payments. And, as the law requires, today's savings are being used to reduce debt in 2003 and 2004 and to hold postage rates steady through 2005.

But by 2006 inflationary cost increases will have whittled away the financial benefit of lower CSRS payments; even without the escrow requirement, we expect that we will have to raise rates in 2006. With the escrow requirement, postage rates will have to rise even more than is necessary to reflect inflation – some have suggested that the increase would be in the double digits. This is because the new rates would have to generate the revenue to cover what is being called the "savings," the difference between the old and new CSRS funding schedule.

And, with a continuing, future escrow-funding requirement, we would have to continually increase rates frequently simply to fund the escrow account. And, as I mentioned, this "hands off" fund could be spent by the Postal Service only with Congressional authorization. Thus without further legislation, the benefits enjoyed by every mail user in the nation – business, nonprofit and consumer – would evaporate as soon as 2006 through the higher rates required to fund the escrow account. This would put postal customers back where they started from before the legislation was enacted – reinstating the very over-funding the legislation was designed to correct.

We propose that the escrow account be eliminated.

We have also offered two alternative proposals if – and only if – the escrow requirement stands.

First, if the $27 billion CSRS military funding requirement is transferred back to the Treasury, the Postal Service would have fully funded and, in fact, over-funded its CSRS payment obligation by $10 billion. We would then be in a financial position to pre-fund retiree health benefit obligations on a current basis for all employees and retirees.

Our second proposal is based on the CSRS military funding requirement remaining an obligation of the Postal Service. If that is the case, the Postal Service proposes that the funds placed in the escrow account be used to begin pre-funding postretirement health benefit costs for newly-hired Postal Service employees.

We have provided our comments on these issues to Congress, the Administration and the General Accounting Office. GAO is reviewing our proposals and will provide a written evaluation to Congress by November 29. Congress will then have 180 days to revisit the issue of the escrow account.

In the near term, the CSRS legislation has resulted in a welcome period of financial stability. 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.

Many – in the Postal Service, the mailing community, and in Congress – have long recognized that the basic business model which guides the operation of America's mail system is becoming increasingly disconnected from today's reality. It is outdated and inflexible. The Postal Reorganization Act that created today's Postal Service in 1970 was predicated on the assumption – valid for most of the last 33 years – that continually growing mail volume would result in continually increasing revenue. That revenue, in turn, would be sufficient to cover the costs of an expanding service network. This is no longer the case.

We are pleased that the President's Commission has reached a similar conclusion. The facts speak for themselves.

Including our preliminary estimate for fiscal year 2003, mail volume has declined in each of the last three fiscal years, dropping close to six billion pieces from its peak. During the same three-year period, the number of addresses we serve increased by 5.2 million.

This combination of factors – declining mail volume contrasted with the costs of a still-growing service network – resulted in a net loss in two of the last three years. Cumulatively, those losses amounted to $2.3 billion.

While our financial results for Fiscal Year 2003 were positive, with an unaudited net income of approximately $3.9 billion, this reflects the impact of legislation that reduced the Postal Service's obligation to the Civil Service Retirement System.

Of course, a number of external factors contributed to mail volume losses since 2001. These included the 9/11 terrorist attacks, the use of the mail for bioterrorism and, most significantly, the effects of a difficult economy.

Profound structural changes are also at work. These include the increasing use of electronic communications for transactions that, in the past, had almost universally taken place through the mail. The robust growth of private-sector delivery services – from packages to time-sensitive communications – has also altered the competitive landscape. We do not expect that these factors will necessarily result in absolute mail volume loss in the foreseeable future. But they will, at the very least, contribute to a diminished rate of mail volume growth as our delivery infrastructure – and its associated costs – continues to expand. This will place extreme pressure on our bottom line. Significantly, volume trends indicate that First-Class Mail, which provides the greatest contribution to supporting system overhead, may continue its decline.

To that end, President Bush, in December 2002, created a Commission to examine the Postal Service and to prepare a report defining a proposed vision for its future and recommending legislative and administrative reforms needed to ensure the vitality of postal services for the American people.

I thank the Administration for its willingness to take on this critical public policy challenge sooner rather than later. In particular, I would like to recognize the efforts of Peter Fisher, former Under Secretary of the Treasury for Domestic Finance, for his role in implementing the President's mandate. His guidance resulted in a Commission that took the time to understand the scope and complexity of the Postal Service, recognize its critical role to the nation, and hear from representatives of every group with an interest in the future of the nation's mail service.

Co-Chairs James Johnson and Harry Pearce – and all of the Commissioners – are to be commended for their focus and dedication to this task. They understand the forces that are threatening the ability of the Postal Service to succeed in a new century – one with communications options unheard of just a few years ago. They understand the need to define a new business model to protect the ability of the government to provide this vital service without undue expense to taxpayers or to postal ratepayers. Most importantly, they understand the need to act before there is a crisis that imposes hardship on the public.

To some observers, a recognition that the Postal Service has been on a path of continuous improvement, can lead to the conclusion that no significant change is necessary. The need for change may not become apparent to everyday mail users until the inflexibilities of our dated business model begin to affect service and the price of postage. We cannot afford to let this happen.

In many areas, we accept the Commission's recommendations, particularly where its report calls for continuing the efforts initiated through our Transformation Plan. We will continue to move forward on them.

We will continue the pursuit of strategic partnerships with the private sector where they help us enhance efficiency, reduce costs or improve service. Areas under review include mail transportation, retail operations, delivery service, and many other activities that support our core business.

We will continue to work with the mailing industry to encourage and support the expansion of worksharing where it makes sense. This provides mailers with strong financial benefits encouraging the use of mail and contributes to more efficient operations for the Postal Service.

We will continue more innovative approaches to how we buy products and services. Our transition to master buying agreements in key areas has saved

$200 million in fiscal year 2003 alone. We will pursue every opportunity to benefit by similar agreements in as wide a range of buying activities as possible. Within the scope of existing legislation, we will also revise our purchasing regulations to reflect corporate best practices that can improve our operating and administrative practices and ensure that we receive maximum value with every purchase.

We accept the Commission's view that the Postal Service should enhance its financial reporting. While the Commission notes that, in many respects, our reporting often exceeds what is required of Federal agencies, the Commission recommends that our reporting match the level of disclosure offered by our corporate peers. Accordingly, we will continue to transition our financial reporting to satisfy standard Securities and Exchange Commission requirements, where those requirements make sense when applied to a non-publicly traded, non-stockholder owned company.

We agree with the Commission that electronic technology offers a way to increase the value of the mail at every step – from acceptance to delivery – for the sender, the recipient and the Postal Service. Our Intelligent Mail initiative and its "One Code" vision will be instrumental in achieving many of the advances – both in processing efficiency and providing information for mail users – envisioned by the Commission. We must give appropriate attention, however, to the concerns of our customers, including those regarding privacy protection, which may be raised by the recommendation that every mailpiece bear a unique identifier.

The Postal Service shares broad agreement on many of the critical, structural issues treated in the Commission's report.

The report recognizes that the Postal Service requires additional flexibility if it is to take advantage of corporate best practices that are necessary for long term success in serving the nation. In short, management needs the flexibility to manage.

We agree with the Commission that the establishment of a rate-ceiling or price cap offers some additional pricing flexibility not provided by our present cumbersome, time-consuming, litigious pricing regime. Over the last few years, we have seen a growing consensus, within the mailing community and through previous postal legislative reform efforts, for a pricing structure that will increase rate predictability for customers and provide management with additional flexibility to respond to market needs.

A properly constructed price cap proposal can accomplish both of these goals. But we caution that such a cap must be carefully constructed so that it succeeds in driving maximum operational efficiency, but does not undermine the legitimate financial needs of the organization.

We agree that there should be separate processes for pricing non-competitive and competitive products and services. However, we believe that more work needs to be done to ensure that the definitions of non-competitive and competitive products carefully reflect marketplace reality.

The Postal Service and the Commission agree the Postal Service should have the opportunity to retain earnings – as requested in our Transformation Plan. This would provide a revenue stream that could finance capital expenditures and "smooth out" business cycle impacts on overall financial performance. Yet there must be safeguards so that severely limiting price caps do not serve as an artificial barrier to achieving retained earnings, and that retained earnings are sufficient to achieve their purpose.

We agree with the Commission that the letter and mailbox monopolies are essential to support a universal service mandate. The Commission's report would give a Postal Regulatory Board the authority to examine and modify these monopolies from time to time. We believe any modification must be in the public interest, must not undermine the Postal Service's ability to maintain universal service, and must protect the security and privacy of what is placed in the mailbox.

We agree with the Commission, generally, in its description of the Postal Service's core mission: offering products and services directly related to the delivery of letters, newspapers, magazines, advertising mail and parcels. But we do have concerns about the Commission's recommendation that the Postal Service be limited by statute to only those activities. We are facing an uncertain future. The Commission's own projections call for a mail volume decline of five percent by 2017, and, for that same year, a Postal Service deficit of $8.5 billion. We strongly believe that it is necessary for the Postal Service to have the flexibility to pursue appropriate new revenue streams to protect our ability to provide universal service.

We agree with the Commission that the Postal Service must have the ability to alter its retail and processing networks to meet changing customer needs, provide increased access and achieve greater operational efficiency. Yet the proposed Postal Network Optimization Commission could take away the Postal Service's existing authority to better integrate and align its network.

While the new process offers many attractive features, including providing for valuable input from affected stakeholders, including Congress, it should not exclude the Postal Service from the decision-making process. Clearly, the expertise gained from day-to-day operation of the Postal Service's network should play a substantive role in any decisions to change that network, including any decisions to consolidate or close processing facilities. Despite the rationale for its establishment, we believe that the proposed network optimization process may lead to office-by-office or facility-by-facility decisions, rather than focusing on the efficient operation of the network as a whole.

We agree with the Commission that the Postal Service, its employees and the unions that represent them would benefit by a more efficient collective-bargaining process. We also agree that 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.

We agree with the Commission that collective-bargaining should include the ability of the parties to negotiate for benefits as well as wages. Because 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.

In short, on many key issues, the Postal Service and the Commission have a basic level of agreement. This is an encouraging beginning. At the same time, as I have pointed out, many of the challenges are in the details.

As an example, in the area of governance, the Commission recommends significant changes to our governing board. The Governors of the Postal Service are today appointed by the President with the advice and consent of the Senate. The law requires that no more than five may belong to the same political party. This has allowed the Postal Service to enjoy bipartisan oversight for the last three decades.

We are concerned that the Commission's proposed new Board of Directors could change this. The President would appoint three Board members. They, in turn, would 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, with the concurrence of the Secretary of the Treasury. There would be no limits on the political affiliation of Board members, and only the President or the Secretary of the Treasury could remove them. This could result in a highly-partisan Board. Moreover, the Senate's current statutory role of "advice and consent" in connection with Board appointees would be eliminated.

Despite the areas in which we have questions or concerns with the Commission's recommendations, the Postal Service fully understands and accepts that with an increased level of management flexibility comes an increased level of oversight. This provides the necessary balance to protect the public interest.

The Commission proposes 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 Presidential 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, these are clearly issues of broad public policy. 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.

Similarly, the Commission's recommendations would remove the determination of how much money is needed to run the nation's postal system from the operators – those with the day-to-day responsibility of running the postal system – and transfer it to the Postal Regulatory Board. This would occur through the new rate-setting mechanisms recommended by the Commission. At the very least, those provisions should recognize that the Postal Service is a labor-intensive industry which operates as part of our economy's service sector.

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.

Since the advent of collective bargaining in the Postal Service in 1971, there have been voices from all sides on whether postal wages were or were not comparable with private-sector wages, as required by current law. The Postal Regulatory Board would be charged with making a "comparability" determination that would presumably end that argument.

But the issue of comparability is dynamic and depends on economic factors and job skill requirements that can change with time and circumstances. A wage comparability determination made by an independent Postal Regulatory Board may inform periodic contract negotiations, but it is important to permit the Postal Service and its unions to engage in direct negotiations which balance the needs of all parties without requiring strict adherence to the results of any specific comparability determination.

Speaking to you today, I am reminded of the efforts in the late 1960s to define a new and better model for the postal system in the United States. At a hearing not unlike this one, one of my predecessors, Postmaster General Larry O'Brien was asked by Representative Tom Steed, Chairman of the House Appropriations Subcommittee:

> General, would this be a fair summary: that at the present time, as manager of the Post Office Department, you have no control over your work load, you have no control over the rates of revenue that you are able to bring in, you have no control over the pay rates of the employees that you employ, you have very little control over the conditions of the service of these employees, you have virtually no control, by the nature of it, of the physical facilities that you are forced to use, and you have only a limited control at best over the transportation facilities that you are compelled to use . . . This is a staggering amount of "no control" in terms of the duties you have to perform.

Postmaster General O'Brien agreed.

And, in reviewing the details of some of the Commission's recommendations, particularly those related to the Postal Regulatory Board, I feel somewhat like Larry O'Brien did. In return for some basic elements of rate-setting flexibility, the Postal Service is asked to cede a staggering amount of control in areas that – for both government and the private sector – are traditionally at the core of the decisions and responsibilities of management.

The mail is today – and will remain for many years to come – a critical element of our nation's infrastructure. We believe there is a 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.

I am encouraged by the interest this Committee has demonstrated by holding a series of hearings to explore the recommendations of the President's Commission on the Postal Service. The Commission has added a new voice to the important conversation about the future of America's mail system. It is not a conversation that can be limited to the Postal Service and its industry partners. It is a conversation that will result in broad public policy decisions that will affect every family, every business and every community in the nation. For that reason, the decisions that are made must be in the public interest and they must reflect the will of the Congress and the Administration.

Mr. Chairman, I have been asked for my vision of the Postal Service. We need a Postal Service that is incented to improve service and productivity. We need a Postal Service that is given the flexibility to reduce costs. We need a Postal Service that has the ability to implement rates that are responsive to the market and that will mitigate large rate increases that have become counterproductive. We need a Postal Service that has the ability to work with and treat customers as individuals with individual needs. We need a Postal Service where our products, services and systems are available to those we serve where they are located, not just where there are Post Offices. Finally – and importantly – we need to retain a motivated and informed workforce to provide universal service to every home and business in the nation.

I look forward to working with this Committee and with the Congress to identify the business model that will enable the Postal Service to serve everyone in America, today and far into the future.

I pledge to provide the cooperation, the resources and the support that will enable us to do that. We cannot afford to do otherwise.

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

# # # #

United States General Accounting Office

GAO

Testimony
Before the Senate Committee on Governmental Affairs

For Release on Delivery
Expected at 2:00 p.m. EST
Wednesday, November 5, 2003

U.S. POSTAL SERVICE

Bold Action Needed to Continue Progress on Postal Transformation

Statement of David M. Walker,
Comptroller General of the United States

GAO-04-108T

November 5, 2003

GAO
Accountability · Integrity · Reliability

Highlights

Highlights of GAO-04-108T, a testimony before the Senate Committee on Governmental Affairs

U.S. POSTAL SERVICE

Bold Action Needed to Continue Progress on Postal Transformation

Why GAO Did This Study

Last year the President established a commission to examine the future of the U.S. Postal Service (the Service). Its report, issued in July 2003, contained a proposed vision for the Service and recommendations to ensure the viability of postal services. GAO was asked to discuss (1) its perspective on the commission's report and (2) suggestions for next steps. This testimony is based on GAO's analysis of the Commission's report and prior GAO reports and testimonies.

What GAO Recommends

GAO believes that Congress should consider the Commission's recommendations and enact comprehensive postal reform legislation that would clarify the Service's mission and role; enhance governance, accountability, oversight, and transparency; improve regulation of postal rates; and make human capital reforms.

GAO also recommends that the Postmaster General develop a comprehensive plan to optimize its infrastructure and workforce, in collaboration with its key stakeholders, and make it publicly available. In addition, the Postmaster General should provide periodic updates to Congress and the public on the status of implementing its transformation initiatives and other Commission recommendations that fall within the scope of its existing authority. Postal officials have agreed to take these actions.

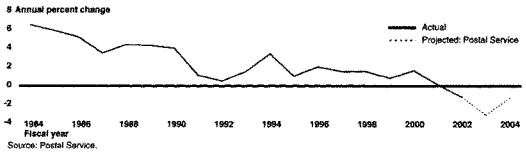
www.gao.gov/cgi-bin/getrpt?GAO-04-108T.

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

What GAO Found

The Commission found that the Service faces a bleak fiscal outlook. The Service has an outdated and inflexible business model amid a rapidly changing postal landscape. First-Class Mail appears to be on the brink of long-term decline as Americans take advantage of cheaper electronic alternatives. Thus, universal postal service is at risk. These findings are similar to our past work and point to the need for fundamental reforms to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases. The Commission made recommendations to Congress and the Service aimed at achieving such reforms, which GAO believes merit consideration.

First Class Mail Volume Growth from Fiscal Years 1984-2004



Source: Postal Service.

GAO agrees with the Commission that now is the time to modernize the nation's postal laws rather than waiting until a financial crisis occurs that limits congressional options. Key aspects of the Service's existing legislative framework that need to be addressed are 1) a broadly defined mission that enables the Service to engage in unprofitable and controversial endeavors, 2) a governance structure that does not ensure governing board members who have the requisite knowledge and skills, 3) the need for additional accountability, oversight, and transparency provisions; 4) a lengthy, burdensome rate-setting process, and 5) provisions that hinder the Service in rationalizing its infrastructure and workforce.

GAO also agrees with the Commission that the Service can take steps now to modernize and increase efficiency and effectiveness, improve its financial position, and rationalize its infrastructure and workforce. The Service has begun to implement its Transformation Plan initiatives, cut its costs and the size of its workforce, and improve its efficiency. However, since the Service issued its Transformation Plan in April 2002, it has not provided adequate transparency on its overall plans to rationalize its infrastructure and workforce; the status of initiatives included in its Transformation Plan; and how it plans to integrate the strategies, timing, and funding necessary to move toward becoming a high-performing organization. The Service's vision of rightsizing its infrastructure and workforce is achievable if approached in a comprehensive, integrated fashion, with appropriate communication and coordination with postal stakeholders.

Chairman Collins and Members of the Committee:

I am pleased to be here today to participate in this hearing on the report of the President's Commission on the United States Postal Service (the Commission).[1] Recently, the U.S. Postal Service (the Service) has gained some financial breathing room because recently enacted legislation has reduced the Service's payments for its pension obligations. The Service has estimated that its net income in fiscal year 2003 will be over $4 billion, of which about $3 billion was the result of recent legislation. However, the Service's long-term financial challenges remain, and, accordingly, the Service's long-term outlook and transformation efforts remain on our High-Risk List. Since we placed the Service on our High-Risk List in April 2001, the Service has developed its 2002 Transformation Plan, cut various costs, and improved its productivity. However, these incremental steps cannot resolve the fundamental and systemic issues associated with the Service's current business model.

We have called for actions to address the Service's financial situation and long-term outlook, including overhauling its existing business model. We previously suggested that a commission could be established to study postal issues and make recommendations, and like you, were pleased that the President established the Commission to propose a vision for the future of the Service and recommendations to ensure the viability of postal services. As we testified before the Commission, fundamental changes will need to be made to the Service's business model, and the legal and regulatory framework that supports it, to provide for the Service's long-term financial viability. The Commission proposed far-reaching changes in each of these areas. The vision for the Service set forth in the Commission's report, combined with its comprehensive recommendations, has the potential to fundamentally affect the nature of postal services, their cost, and how they are provided to the American people.

In my testimony today, I will discuss our perspective on the Commission's report and offer suggestions on steps that Congress and the Service need to take for continued progress on postal transformation. My testimony today is based on our analysis of the Commission's report, discussions

[1]President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, (Washington, D.C.: July 31, 2003).

with postal stakeholders, prior GAO reports and testimonies on postal transformation issues, and our continuing work in this area.[2]

Summary

Overall, the Commission's report provides a valuable contribution to assist Congress, the Service, the executive branch, and stakeholders in considering the actions needed to transform the Postal Service to a more high-performing, results-oriented, transparent, and accountable organization. The Commission found that the Postal Service's current business model has not produced the desired results because it has led to poor financial results, difficulty in funding capital needs, lack of incentives for good financial performance, and lack of efficiency. The Commission offered constructive suggestions, some of which require legislative change, and some that can be implemented under the existing statutory framework.

The Commission's recommendations echo many of our prior reports and address concerns that we have previously raised. We agree with the Commission that an incremental approach to Postal Service reform will yield too little too late given the enterprise's bleak fiscal outlook, the magnitude of its financial obligations, the likelihood of declining First-Class Mail volumes, and the limited potential of the Service's legacy postal network. All options for statutory and discretionary change need to be on the table for discussion, including the Commission's findings and recommendations, as well as suggestions from GAO and other stakeholders. Some of the Commission's recommendations, such as those related to rate setting, oversight, and collective bargaining, involve complex and controversial issues that may require further consideration and refinement. Nevertheless, the time has come for Congress to enact comprehensive postal reform legislation that would clarify the Service's mission and role; enhance governance, accountability, oversight, and transparency; improve regulation of postal rates; and make human capital reforms.

In addition to statutory reform, we agree with the Commission that the Service has many opportunities to become more efficient, notably by

[2]See U.S. General Accounting Office, *U.S. Postal Service: Key Postal Transformation Issues*, GAO-03-812T (Washington, D.C.: May 29, 2003); *Major Management Challenges and Program Risks: U.S. Postal Service*, GAO-03-118 (Washington, D.C.: Jan. 2003); and *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002).

standardizing its operations and reducing excess capacity in its network. This vision is achievable if approached in a comprehensive, integrated fashion, and supported by postal stakeholders. The impending retirement of much of the Service's workforce provides an opportunity to rightsize the organization with minimal disruption. However, the Service has not provided adequate transparency on its plans to rationalize its infrastructure and workforce, as well as on the status of initiatives included in its Transformation Plan. More constructive engagement on its efforts to rationalize its infrastructure and workforce is needed with the Service's employee organizations, the mailing industry, affected communities, and Congress. To facilitate the Service's progress in implementing actions under the existing system, we recommend that the Postmaster General develop a comprehensive and integrated plan to optimize its infrastructure and workforce, in collaboration with its key stakeholders, and make it available to Congress and the general public. In addition, the Postmaster General should provide periodic updates to Congress and the public on the status of implementing its transformation initiatives and other Commission recommendations that fall within the scope of its existing authority. In discussing our recommendations with postal officials, they agreed to take these actions.

We also share the Commission's concerns about the Service's funding of its $92 billion in liabilities and obligations, which include about $48 billion in unfunded retiree health benefits, about $6.5 billion for unfunded workers' compensation benefits, and about $5.8 billion for unfunded Civil Service Retirement System (CSRS) pension obligations. Although recent legislation has addressed how the Service will cover its CSRS pension obligations over 40 years, the Service continues to make minimum payments for the other obligations, which are currently financed on a pay-as-you go basis. Based on known demographic trends, the Service's share of its retirees' health insurance premiums is expected to continue rising until about 2040. Under the Service's existing accounting and rate-setting methods, more significant and frequent rate hikes are likely to be needed for future ratepayers to cover the costs of benefits that are being earned by current employees. We recognize that building accrual-based measures of retiree health costs into the current rate base may be difficult considering the pressure to defer rate increases. However, in our view, it would be more prudent to address the unfunded obligations in a manner that is fair and balanced for both current and future ratepayers. The Postal Service has provided Congress with proposals for funding retiree health benefit obligations, which we will address in our forthcoming report in this area.

The Commission's Report Made Valuable Contributions

Overall, the Commission's report provides a valuable contribution to assist Congress, the Service, the executive branch, and stakeholders in considering the actions needed to transform the Postal Service into a more high-performing, results-oriented, and accountable organization. Tomorrow, we plan to hold a forum at GAO with Postmaster General Jack Potter and other national leaders and experts to discuss ways in which Congress and the executive branch can foster federal agencies' and their networks' efforts to become high-performing organizations.

We are pleased that the Commission's report facilitated consideration and debate by presenting the issues in a way that can be understood by a general audience, and we commend the Commission for the open and transparent process used to engage stakeholders in developing its report. We also share the report's emphasis on a customer-oriented Postal Service that can continue to meet the nation's vital need for universal postal service. Citizens and businesses depend on the Service to provide affordable postal services that are essential for communications and commerce on a universal basis.

The Commission's report also made an important contribution by addressing difficult infrastructure and human capital issues. We agree with the Commission that transforming the Service will require a fundamental reexamination and realignment in both of these areas, which collectively account for most of the Service's costs and are the linchpin to delivering high-quality service. As the Commission noted, the nation's communications, technology, and delivery markets have seen vast changes since the Postal Service was created by the Postal Reorganization Act of 1970. New types of electronic communications include the use of e-mail, wireless technology, and electronic bill payment services. These changes appear to have placed First-Class Mail volume in the early stages of what may be a long-term decline.

In this new environment, unless the Service's operating expenses can be reduced correspondingly, with a rightsizing of both its infrastructure and workforce, it is questionable whether affordable universal mail service can be sustained over the long term with a self-financing public institution. Further, it takes time for an organization as large and complex as the Service to make fundamental changes, particularly when some of these may hinge on congressional action. Fortunately, the Commission and others, including the Service, have identified numerous changes, many of them possible within existing law, which can reduce the Service's

operating costs while maintaining and enhancing the quality and value of postal services.

With respect to human capital issues, the Commission has recognized that management reform and improvements in managing the Service's employees will be vital to comprehensive postal transformation. We applaud the Commission's efforts to develop new approaches in these areas. While postal stakeholders may differ over the Commission's recommendations, we share the Commission's view that the status quo is not a viable option. All options for statutory and discretionary change need to be on the table for discussion. If the Service and its employee unions do not believe that some of the Commission's workforce recommendations are viable, we believe that alternative solutions, or a package approach, to the workforce issues raised by the Commission and us in our previous work need to be explored.

The Need for Comprehensive Postal Reform Legislation

The Commission recognized that comprehensive reform to the nation's postal laws is needed so that the Service can successfully meet the formidable challenges it faces and continue to provide affordable and high-quality universal postal services. The Commission reported that "it is the Commission's emphatic view that an incremental approach to Postal Service reform will yield too little too late given the enterprise's bleak fiscal outlook, the depth of current debt and unfunded obligations, the downward trend in First-Class Mail volumes and the limited potential of its legacy postal network that was built for a bygone era." We agree. Our prior reports and testimonies have concluded that comprehensive postal reform legislation is needed and have provided information on key issues to be considered.[3] The Commission's findings are generally consistent with our past work, and its recommendations address postal reform issues in a comprehensive manner. Now that the Commission has finished its work, the time has come for Congress to act.

The Commission's recommendations represent a thoughtful package that would preserve the historic values of universal postal service; make important statutory changes in many key areas, including governance,

[3]GAO-03-812T; GAO-02-355; U.S. General Accounting Office, *U.S. Postal Service: Moving Forward on Financial and Transformation Challenges*, GAO-02-694T (Washington, D.C.: May 13, 2002); *U.S. Postal Service: Financial Outlook and Transformation Challenges*, GAO-01-733T (Washington, D.C.: May 15, 2001); and *U.S. Postal Service: Transformation Challenges Present Significant* Risks, GAO-01-598T (Washington, D.C.: Apr. 4, 2001).

oversight, and human capital; and create a mechanism for making further changes over time. In our view, the Postal Service's current financial breathing room gives Congress an opportunity to carefully consider postal transformation issues and "get it right" when making fundamental decisions about rechartering the nation's postal system for the 21st century.

Consistent with the need for Congress to rethink the role of the federal government in the 21st century, now is the time to rethink and clarify the mission and role of the Postal Service. The Commission's report concluded that a number of trends are driving the need for a sweeping exploration of the Postal Service's role and operations in the 21st century. In this regard, we share the Commission's concerns about the likelihood of declining First-Class Mail volumes in both the short-term and the long-term. First-Class Mail generates more than half of the Service's revenue. The revenue generated by First-Class Mail was used to cover about 69 percent of the Service's institutional cost in fiscal year 2002. The loss of contribution from declining First-Class Mail volume would be difficult to recover from other classes of mail. However, the rate of growth for First-Class Mail has been in long-term decline since the 1980s. First-Class Mail volume has steadily declined since it peaked 2 years ago. Its volume is estimated to have declined by 3.1 percent in fiscal year 2003 and is projected to decline by 1.3 percent in fiscal year 2004 (see figure 1).

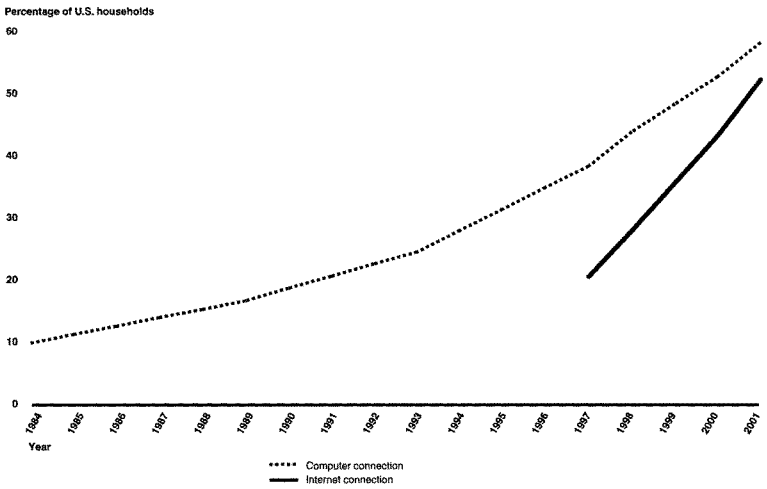
Figure1: First-Class Mail Volume Growth, Fiscal Years 1984 through 2004

Source: Postal Service.

Looking ahead, we share the Commission's concern that electronic diversion of First-Class Mail threatens to significantly accelerate the decline in the Service's mail volume. Although the role of the Internet has been much commented on, it can be easy to overlook the fact that the Internet is a relatively recent historical phenomenon, with use of the World Wide Web greatly increasing in the 1990s. As recently as 5 years ago, only 37 percent of U.S. households had a computer, and only 19 percent of U.S. households were connected to the Internet (see figure 2). The rapid diffusion of computer and Internet technologies has led to high adoption rates among those with high levels of income and education—the same groups that send and receive a disproportionate share of First-Class Mail. Thus, the trend data point to the strong potential for further electronic diversion. Raising postal rates to offset this trend may provide an immediate boost to the Service's revenues, but over the longer term will likely accelerate the transition of mailed communications and payments to

electronic alternatives, including the Internet. A report prepared for the Commission found that growth in electronic payments is likely to be an important factor in its forecast of gradual declines in First-Class Mail volume.[4]

Figure 2: Percent of U.S. Households with Computers and Internet Connections



Sources: U.S. Census Bureau data; GAO presentation.

Note: Data was reported for 1984, 1989, 1993, 1997, 1998, 2000, and 2001.

[4]Institute for the Future, *Two Scenarios of Future Mail Volumes: 2003-2017*, prepared for the President's Commission on the United States Postal Service (Palo Alto, CA: May 2003).

The Commission's report highlighted why the status quo has not produced satisfactory results and is ill suited for the 21st century. Key weaknesses include:

- Uncertain financial future: In theory, the Postal Service is self-supporting through postal revenues. In practice, as the Commission noted, even after recent statutory changes reduced the Service's unfunded liability for Civil Service Retirement System (CSRS) pension benefits, the Service has accumulated about $92 billion in liabilities and obligations over the past three decades. These liabilities and obligations include debt, large unfunded obligations for retiree health benefits obligations, and remaining unfunded pension and workers' compensation liabilities. Thus, current ratepayers have not fully covered the total costs generated to provide the postal services they have received. A continuation of these trends would be diametrically opposed to the Commission's vision of a fiscally sound Postal Service that can sustain universal postal service, particularly if the Service's core business of First-Class Mail continues to decline in the coming years.

- Difficulty financing capital needs: In recent years, the Service has found it problematic to obtain adequate financing for capital needs. Thus, the Service has often increasingly resorted to borrowing to finance its capital improvements. In fiscal year 2001, the Service was faced with insufficient cash flow from operations and with debt balances that were approaching statutory limits. Consequently, the Service imposed a freeze on capital expenditures for most facilities that continued through fiscal years 2002 and 2003. The Service was able to repay some of its debt in fiscal year 2003, primarily because it generated a positive cash flow from a reduction in its pension costs. However, looking forward, it may be difficult for the Service to obtain adequate funds to address its long-term capital needs, including modernizing its aging network of postal facilities, without significantly increasing rates or debt. The Commission's recommendations in the areas of retained earnings and disposition of excess Postal Service real estate represent carefully considered alternatives to help provide the Service with sufficient revenue for both its operating and capital needs.

- Lack of incentives for good financial performance: The "break-even" mandate requires the Service's revenues and appropriations to equal its total estimated costs as nearly as practicable. For many years, this mandate has been interpreted to mean that the Postal Service should break even over time. As such, the break-even mandate removes the profit motive, and the rate-setting structure allows the Postal Service to

cover rising costs by raising rates. Further, the lack of a provision for retained earnings also limits incentives for productivity improvement and cost reduction. Under the current structure, whatever cost reductions the Service achieves in one rate cycle are used to reset the estimated costs that the Service is to recover in the next rate cycle. In contrast, a limited retained earnings provision would enable the Service and its employees to benefit from whatever cost reductions are achieved.

- Lack of efficiency: The Service has improved its efficiency in recent years, but much more progress needs to be made. The Commission identified significant variation in efficiency among mail processing plants and called for more efficient operations through standardization. We agree with the Commission that the Service has significant opportunities to improve its efficiency through best execution strategies in which those who can do it best and at the best price would perform postal activities while the Service rightsizes its infrastructure and workforce. However, as we have previously reported, both legal and practical constraints have hindered progress in these areas.

- Disincentives for maximizing allocation of postal costs: Under the current regulatory model, all classes of mail and types of service must cover their attributable costs, while institutional costs (i.e., common or overhead costs) are allocated based on judgment informed by broad statutory criteria.[5] In effect, the Postal Service loses pricing flexibility as costs are allocated to specific postal products and services, creating a structural disincentive for the Service to maximize cost allocation to various classes of mail and types of service. Understanding, measuring, and reporting postal costs have greatly improved over the years. However, the proportion of postal costs allocated by the Service has increased by only 9 percent since postal reorganization. Further, cost allocation disputes persist, as illustrated by the different methodologies used by the Service and the PRC for allocating mail processing costs—that is, the Service allocated 58 percent of postal costs in fiscal year 2002, while the PRC allocated 62 percent. We recognize that it may be difficult to use the data that are currently collected by the Service to

[5]The Service proposes domestic postage rates and fees, as required in law, so that each class of mail or type of service must cover the direct and indirect postal costs that are attributable to that class or type of service plus a portion of its other remaining "institutional costs" which include all "common" or "overhead" costs. The requirement that each class of mail must cover its attributable costs has long been interpreted to apply to groupings of mail within classes that are called subclasses.

allocate a higher proportion of costs. Nevertheless, the Commission's conclusion that more postal costs can and should be allocated raises the issue of whether increasing regulatory authority over cost allocation would be necessary to ensure that all costs that can be rationally attributed are properly allocated. Furthermore, improvement in the Service's data collection could also enable greater allocation.

Postal Service Mission and Role Need Clarification

It is important for Congress to consider how best to clarify the mission and role of the Postal Service as part of a fundamental reexamination of the role of the federal government in the 21st century. The starting point is to consider the Commission's recommendation that Congress amend the nation's postal laws "to clarify that the mission of the Postal Service is to provide high-quality, essential postal services to all persons and communities by the most cost-effective and efficient means possible at affordable, and where appropriate, uniform rates." This recommendation is coupled with proposals to create a mechanism for change by giving broad authority to a newly created Postal Regulatory Board, including authority to review and issue binding decisions on certain Postal Service proposals to redefine delivery frequency requirements; uniform postal rates; and the Postal Service's monopoly to deliver mail and place items in mailboxes.

The Commission sought to clarify the nature of the Service's universal postal service mission by recommending that Postal Service activities be limited to accepting, collecting, sorting, transporting, and delivering letters, newspapers, magazines, advertising mail, and parcels and providing other governmental services on a reimbursable basis when in the public interest. The Commission recognized that the nation's postal laws did not envision the challenge of setting appropriate boundaries on the Service's commercial activities and maintaining fair competition between the Service and the private sector. These issues need to be addressed because the Service has repeatedly strayed from its core mission. We have reported on the Service's money-losing initiatives in electronic commerce and remittance processing, among other things.[6] The Service's ill-fated ventures were also questioned by some postal stakeholders as unfair competition, since they were cross-subsidized by a

[6]U.S. General Accounting Office, *U.S. Postal Service: Update on E-Commerce Activities and Privacy Protections*, GAO-02-79 (Washington, D.C.: Dec. 21, 2001); *U.S. Postal Service: Postal Activities and Laws Related to Electronic Commerce*, GAO/GGD-00-188 (Washington, D.C.: Sept. 7, 2000), *U.S. Postal Service: Development and Inventory of New Products*, GAO/GGD-99-15 (Washington, D.C.: Nov. 24, 1998).

tax-exempt entity that is also exempt from many laws and regulations governing the private sector. Further, such ventures have raised the fundamental issue of why the federal government is becoming involved in areas that are well served by the private sector. Although the current Postmaster General has appropriately focused on the Service's core business of delivering the mail and sharply curtailed its nonpostal initiatives, the Commission recommended codifying this policy. In our view, the time has come for Congress to clarify the Service's core mission and ensure continuity across changes in postal management.

However, it will be important to understand the implications of generally limiting the Postal Service to its traditional role of handling the nation's mail, as the Commission has recommended. In that event, the Service will face the formidable challenge of maintaining affordable universal postal service by growing revenues or significantly cutting its costs as its core business of First-Class Mail declines. In order to achieve net cost savings, the Service's cost-cutting efforts must currently offset billions of dollars in annual cost increases for general wage increases, cost-of-living adjustments, and rising benefits costs, particularly in health insurance premiums, as well as costs associated with having to deliver mail to over 1.5 million new addresses every year. Declining First-Class Mail volume will intensify the financial squeeze by reducing the volume of highly profitable mail. Thus, if the Service is limited to its traditional role, maintaining the quality and affordability of postal services would likely require dramatic improvement in the Service's efficiency. The Service would need to become a much leaner and more flexible organization and rightsize its network of mail processing and distribution facilities. Consistent with our past work and the testimony of many key stakeholders, the Commission recognized that comprehensive reform of the nation's postal laws would be necessary to facilitate changes in these areas. In the next section of this statement, we discuss the Commission's recommendations involving governance, transparency, accountability, rate setting, and human capital. In our view, revisiting these areas may involve taking substantive and political risks, but we agree with the Commission that such risks must be taken if the Service is to remain successful in the coming decades.

In our view, key questions related to clarifying the Service's mission and role include:

- How should universal postal service be defined, given past changes and future challenges?

- Should the Service be allowed to compete in areas where there are private-sector providers? If so, in what areas and on what terms? What laws should be applied equally to the Service and to its competitors? What transparency and accountability mechanisms are needed to prevent unfair competition and inappropriate cross-subsidization? Should the Service's competitive products and services be subject to antitrust and general competition-related laws? Should they be subject to consumer protection laws?

- Should the Service retain governmental authority, including its regulatory responsibilities and law enforcement functions?

On a related issue, the Service's current statutory monopoly on the delivery of letter mail and its monopoly over access to mailboxes have historically been justified as necessary for the preservation of universal service.[7] However, questions have been raised regarding whether these restrictions continue to be needed, and if so, to what extent and whether the Service should be able to define their scope. A key issue is whether the Postal Service, as a commercial competitor in the overnight and parcel delivery markets, should have the authority to regulate the scope of competition in these areas.[8] The Commission has recommended separating these functions so that the Postal Service cannot define and regulate the scope of its own monopoly.

As the Commission noted, it is a fundamental premise of American justice that parties that administer laws should not have a financial interest in the outcome. Accordingly, the Commission recommended that an independent entity should be responsible for reviewing the costs and benefits of the monopoly as well as for reviewing the thicket of vague and contradictory regulations in this area and modernizing the law to define the postal monopoly in clear and understandable terms. The independent entity could narrow the postal monopoly over time if and when the evidence shows that suppression of competition is not necessary to the protection

[7]For information on the Service's monopoly on mailbox access, see U.S. General Accounting Office, *U.S. Postal Service: Information About Restrictions on Mailbox Access*, GAO/GGD-97-85 (Washington, D.C.: May 30, 1997).

[8]The Service has used its regulatory power to redefine the scope of the statutory monopoly by suspending the monopoly for urgent letters and outbound international mail. The Service has also defined the scope of its monopoly by issuing regulations that define a "letter" for the purposes of enforcing the statute (39 CFR 310.1(a)) as well as regulations specifying access to mailboxes (Domestic Mail Manual, D041 and P011.2.2).

of universal service without undue risk to the taxpayer. Narrowing or eliminating the monopoly could increase consumer choice and provide incentives for the Service to become more effective and efficient. For example, in recent years, FedEx has expanded its role in delivering residential parcels and UPS has shortened its guaranteed transit time on ground shipments traveling to some of the country's biggest metropolitan areas. As Congress considers the Commission's recommendations relating to the postal monopoly, we believe that key questions include:

- Is a government monopoly needed to enable affordable universal postal service, especially if such service is provided at uniform rates? If so, what scope of monopoly is needed to accomplish its goal?
- Should the Service continue to have the power to define (and redefine) its own statutory monopoly through suspensions and regulations?
- Should a regulatory body have authority to redefine and narrow the postal monopoly and the mailbox monopoly, or should such decisions be made through the legislative process? If authority is delegated to a regulatory body, should a clear statement of congressional intent be provided to guide regulatory decisions, or should the regulator have unfettered discretion to consider options to expand or contract the Service's monopoly? What principles should guide the process, and what key players should be involved?
- Similarly, should the regulator be able to consider opening up access to the mailbox? If so, under what circumstances? Would it be cost-effective for private delivery companies to deliver items to mailboxes if individuals could veto access and redefine mailbox access as they move from one home to another?
- Should any regulatory decisions be governed by process requirements to enable stakeholder input? Should such processes facilitate congressional review of any changes, as is the case for some other types of communications regulated by the federal government?

Protecting the Public Interest through Enhanced Transparency, Accountability and Public Policy Oversight

The Commission concluded that the Postal Service must have greater flexibility to operate in a businesslike fashion, but that with this latitude comes the need for enhanced transparency to enable effective management and congressional and other oversight. We agree. As the Commission noted, managerial accountability must come from the top, with the Service governed by a strong corporate-style board that holds its officers responsible for performance. The Commission concluded that giving the Service greater flexibility while preserving its monopoly would

require enhanced oversight by an independent regulatory body endowed with broad authority, adequate resources, and clear direction to protect the public interest and ensure that the Postal Service fulfills its duties. The Commission cited reports that we have issued since September 2000 urging greater financial transparency and expressing concern about sharp declines in the Service's financial position that were accompanied by too little explanation.[9] To enable sufficient accountability, oversight, and transparency, the Commission recommended changes to the Service's governance structure, the creation of a Postal Regulatory Board that would have broad powers, and mechanisms to facilitate and ensure greater transparency of the Service's financial and performance results. Key issues include whether the Commission's recommendations are necessary, have struck the appropriate balance between multiple objectives, and would be practical to implement.

Governance Structure

The Commission found that given its importance to the country and the challenges to its future, the Postal Service should meet the highest standards of corporate leadership, including a strong, strategic Board of Directors coupled with enhanced oversight and financial transparency. Specifically, the Commission concluded that if the Postal Service is to adapt successfully to a changing postal market, overcome its significant financial challenges, and emerge an efficient and more businesslike institution, then it must be guided by a nimble and results-oriented management and corporate governance structure charged with applying the best business practices of the private sector to the public-spirited mission of delivering the nation's mail. We agree. As we have reported, if the Service is to successfully operate in a more competitive environment, the role and structure of a private-sector board of directors may be a more appropriate guide in this area.[10] Having a well-qualified, independent, adequately resourced, and accountable board is critical for a major federal institution with annual revenues approaching $70 billion and approximately 829,000 employees.

[9]The Commission cited GAO-03-118; GAO-02-694T; GAO-02-355; GAO-01-733T; GAO-01-598T; U.S. General Accounting Office, *U.S. Postal Service Actions to Improve Its Financial* Reporting, GAO-03-26R (Washington, D.C.: Nov. 13, 2002); and *U.S. Postal Service: Enhancements Needed in Performance Planning and Reporting*, GAO-00-207 (Washington, D.C.: Sept. 19, 2000).

[10]GAO-03-812T.

Another concern is what qualification requirements would be appropriate for the Postal Service's governing board to ensure that it possesses the kind of expertise necessary to oversee a major government business. Consistent with this view, the Commission recommended that all directors should be selected based on "business acumen and other experience necessary to manage an enterprise of the Postal Service's size and significance." The report also suggested that the board possess "significant financial and business expertise" and that among other things, board members have no material relationship with the Service or its management team. However, the Commission recommended that these criteria be incorporated into the Board's bylaws or governance guidelines rather than into statute.

In this area, we believe that potential issues include:

- Would the proposed qualification requirements be sufficient to produce a well-qualified board with outstanding and experienced directors, in part because of the flexibility inherent in the appointment process?
- Would the proposed board become politicized, in part because most directors would be subject to approval and removal by a political appointee, (i.e., the Secretary of the Treasury), with no Senate confirmation, no requirement for the board to have a bipartisan membership, and the possibility of removal for any reason?
- Would the pool of qualified candidates be unduly restricted because some corporations have a material relationship with the Service, while some retired corporate leaders would be over the proposed mandatory retirement age of 70 for Service board members?
- Would selection of members of the proposed board of directors by an official other than the President be consistent with the Appointments Clause in Article II, section 2, clause 2 of the Constitution, which requires that the heads of executive branch departments be appointed directly by the President with the advice and consent of the Senate?[11]

[11]In *Silver v. U.S. Postal Service*, 951 F.2d 1033 (9th Cir. 1991), the Court held that the Postal Service, as an independent establishment of the executive branch, is subject to the Appointments Clause. The Court further held that the postal governors were the head of the Postal Service, and thus, were required to be appointed by the President and confirmed by the Senate.

- We believe that these concerns merit careful consideration, as well as other concerns on which we have previously reported.[12] In particular, it is debatable whether it would be appropriate for the Secretary of the Treasury to have the authority to approve most future appointments to the governing board of the Service, which fulfills vital government functions and includes nearly one-third of the federal civilian workforce. An alternative option may be to have a number of persons, including the Secretary of the Treasury, to advise the President on such appointments. Another key issue is whether these appointments should continue to be made with the advice and consent of the Senate, which is a mechanism to involve the legislative branch in matters of postal governance. However, we agree with the Commission's conclusion that the legacy governance structure of the Service is increasingly at odds with its mission in the modern environment and that the Service's governing structure needs to consist of members with the requisite knowledge and experience.

The Commission's report made a contribution in identifying the fundamental activities necessary for good corporate governance. The report made a number of recommendations for the proposed board of directors to more effectively discharge its duties, including refocusing the board on a high-level strategic focus on cost reduction and service quality, as well as minimizing the financial risk to taxpayers and restoring the fiscal health of the institution as a whole. In this regard, we believe that the current Board of Governors should refocus its activities along the lines suggested by the Commission.

Accountability Mechanisms

We have reported that a major issue related to the Service's mission and role is whether the Service should be held more directly accountable for its performance, and if so, to what extent, to whom, and with what mechanisms.[13] Specifically, how should the Service's governing board be held accountable? The Commission found that the Service urgently needs a vigilant, broadly empowered and independent regulatory body to focus on its ability to fulfill its core duties in an appropriate and effective manner. The Commission recommended that the Postal Rate Commission be abolished and replaced with a newly created Postal Regulatory Board endowed with broad public policy responsibilities as well as broad

[12]U.S. General Accounting Office, *U.S. Postal Service: Issues Related to Governance of the Postal Service*, GAO/GGD-97-141 (Washington, D.C.: Aug. 14, 1997).

[13]GAO-03-812T.

mandates and authority for accountability and oversight. The regulator would also have authority in numerous areas including rate setting, retained earnings, financial transparency, service standards, performance reporting, and enforcing pay comparability, among others.

A key objective of the Commission's recommendations was to focus the proposed Postal Service board of directors on the business aspects of the Postal Service while transferring public policy responsibilities from the Service to an independent regulator with no stake in the outcome. The recommendations also would transfer key public policy responsibilities from Congress to the regulator. For example, the newly created regulatory body could, over time, redefine the Service's universal service mission and statutory monopoly. The Commission's accountability and oversight provisions would make major changes to the current structure. Thus, the Commission's recommendations in this area raise fundamental issues. In our view, key questions include:

- Who should make public policy decisions regarding the Postal Service: the Service, an independent regulator, or Congress?
- What accountability should apply to a monopoly provider of vital postal services that also is a major competitor in the communications and delivery marketplace?
- How should the Service be held accountable if it remains an independent establishment of the executive branch?
- To what extent should the Service be accountable to Congress and the executive branch without being subject to undue political control?
- To what extent should a regulatory body exercise accountability? For what purpose? With what authority?
- Although additional oversight of the Service appears necessary, would the Service have sufficient management flexibility given the fairly broad authority the Commission proposes be given to the regulatory body?
- How should the regulatory body be structured to preserve its independence from political control and minimize the risk of regulatory capture?

- What statutory guidance and constraints should apply to regulatory actions, including due process and recourse to judicial and/or congressional review?
- What transparency of financial and performance results is appropriate for the Service as a federal establishment and would be necessary for oversight and accountability? What mechanisms should be established to facilitate and ensure transparency?
- Should the Service comply, either on a voluntary basis or through a statutory requirement, with major Securities and Exchange Commission (SEC) reporting requirements?

Enhancing Transparency of Financial and Performance Information

The Commission noted that as a public entity, the Postal Service is wholly owned by the American people, who, as the Service's shareholders, are due a regular and full accounting of the fiscal health and challenges facing this vital national institution. The Commission stated that the Service has a responsibility to the public to be transparent in its financial reporting. We agree. Reporting requirements should ensure accountability and transparency of financial and organizational reports. We have recommended that the Postal Service improve its transparency,[14] and to the Service's credit, it has made progress in providing greater transparency on its financial results and outlook. The Service has instituted quarterly financial reports, expanded the discussion of financial matters in its annual report, and included more information and explanation in the financial and operating statements prepared for each 4-week accounting period. The Service has also upgraded its Web site to include these and other reports in a readily accessible format. The Service is clearly moving in the right direction. However, we agree with the Commission that more progress can and should be made.

In an area where we have particular concern that the Service have transparent, appropriate accounting, the Commission recommended that the Service's governing board work with its independent auditor to determine the most appropriate accounting treatment of the Service's unfunded retiree health benefit obligations in accordance with applicable accounting standards. The Commission also recommended that the board consider funding a reserve account to address these obligations to the

[14]GAO-02-355.

extent that Postal Service finances permit. These recommendations are similar to our previous statements, which noted that

- the Service's current accounting treatment does not reflect the legal nature and the economic reality of its related obligation to pay for these costs;
- the Service's treatment of retiree health benefit costs in its financial statements has not sufficiently recognized the magnitude, importance, or meaning of this obligation to decision makers or stakeholders; and
- because the retiree health benefit obligations are funded on a pay-as-you-go basis, rather than on a full accrual basis, current ratepayers are not paying for the full costs of the services they are receiving.

We continue to believe that the time has come for the Service to formally reassess how it accounts for and discloses these very significant financial obligations. In our view, given the legal nature, economic substance, and stakeholder implication of these obligations, the Service should account for these retiree health costs and related obligations in its financial statements on an accrual basis. We recognize that a change to accrual accounting could have a significant impact on rates. However, the Service could work with the PRC and other stakeholders to determine how best to phase in such a change to mitigate the immediate impact on ratepayers. Regardless of whether the Service changes its accounting for retiree health costs, we continue to believe the Service should disclose the funded status of all of its retiree health and pension obligations.

The Commission enunciated an ambitious standard for the Service when it stated that "As a unifying force in American commerce and society, and as a customer-financed government endeavor, the Postal Service should be setting the standard for financial transparency by which all other Federal entities are judged." [Emphasis in original.] The Commission also found that given its important public mission and central role in the nation's economy, changes in the Service's economic health should not come as a surprise to those responsible for or impacted by its performance. In this regard, the Commission found that while the Service often conducts financial reporting over and above what is required by federal agencies, it remains behind the level of disclosure offered by its corporate peers.

We believe that technical compliance with accounting and reporting requirements should be a floor for financial transparency, not a ceiling. Thus, we were pleased that in keeping with its theme of incorporating best

practices, the Commission said it "strongly recommends" that the Service voluntarily comply with major Securities and Exchange Commission (SEC) reporting requirements. The Service has the opportunity to proactively work with the SEC to define how it could voluntarily comply with SEC requirements in a manner appropriate to its unique legal status.

Enhanced financial transparency is particularly important because the Service is the hub of a $900 billion mailing industry and is a vital part of the nation's communications and payment network. Its recent financial difficulties have accentuated the need for stakeholders to be well apprised of the Service's financial situation and to understand how future operating results may be affected by impending events. Although the Service has traditionally provided a range of detailed financial and operating data to stakeholders throughout the fiscal year, its periodic financial reports did not clearly explain changes in its financial condition, results of operations, and its outlook, and were not always readily available to the public. Thus, in April 2001, we recommended that the Service provide quarterly financial reports to Congress and the public with sufficiently detailed information for stakeholders to understand the Service's current and projected financial condition and how its outlook may have changed since the previous quarter.[15] In November 2002, we found that the Service's financial reports provided to date had provided only limited analysis and explanations to help stakeholders understand what had changed, why it had changed, and how these changes affected the Service's current financial situation and expected outlook.[16] Since then, the Service has improved its quarterly financial reports. We also discussed the SEC's reporting structure as a model for the Service to consider.

As the Commission recognized, the Service remains a public institution with a monopoly on providing vital postal services to the nation, and enhanced financial information will be essential to improve managerial accountability and public policy oversight. In this regard, there are areas where stakeholders have little information, such as the Service's unmet financial needs to maintain and modernize its infrastructure, or the true market value of the Service's vast real estate holdings. Therefore, progress in enhancing the Service's financial transparency is worthy of continued congressional attention.

[15]GAO-01-598T.

[16]GAO-03-26R.

In addition to the above areas, we have reported on, and continue to have concerns about, the Service's annual performance reporting that is required under the Government Performance and Results Act (GPRA).[17] The Service's recently filed 5-Year Strategic Plan for Fiscal Years 2004-2008 contained a clear mission statement and presented a useful discussion of the prospects for mail volume, including three specific forecasts. However, the plan represented a missed opportunity because it failed to adequately communicate what the Service intends to accomplish over the period covered by the plan. For example, the plan contained little new information on the Service's goals and strategies for network and workforce realignment over the next 5 years. The plan continues a trend in which the Service's GPRA reports have provided less and less new information to Congress, postal stakeholders, and the American people.

We also continue to be concerned that the Service does not communicate its delivery performance for all of its major mail categories, particularly those covered by its statutory monopoly to deliver letter mail. The Service's customers should have a right to know what they are getting for their money, particularly captive customers with few or no alternatives to using the mail. However, the Service's public reporting is limited to on-time delivery of First-Class Mail deposited in collection boxes[18] and does not include bulk mailing of First-Class Mail by businesses. In addition, stakeholders and individuals have expressed concerns about the accuracy of mail delivery, but no public information is provided for this aspect of mail service. The Commission recognized that information about service quality would become even more important if the Service obtains more flexibility and incentives to cut its costs. Accordingly, the Commission recommended that the Postal Regulatory Board be required to prepare a comprehensive annual report assessing the Postal Service's performance in meeting established service standards. If such a report is to be meaningful, the regulator may also need authority to require the Service to collect service performance data.

Without sufficient transparency, it is difficult to hold management accountable for results and conduct independent oversight. The Service has the opportunity to seek out best practices and continually improve as standards evolve and experience accumulates, and its recent track record

[17]GAO/GGD-00-207.

[18]First-Class Mail measurement is further limited to collection boxes located in 463 ZIP Codes from which most First-Class Mail volume originates and to which it is destined.

suggests that some improvement is possible. A key issue is whether statutory change is needed to enhance the level of transparency that the Service must provide, particularly if it obtains greater flexibility along the lines recommended by the Commission.

Rate-setting Structure

The Commission concluded that it is imperative that the Postal Service, an institution with a statutory monopoly over the delivery of letter mail, have clear, independent regulatory oversight that includes oversight over its postal rates. The Commission found that the current statutory structure produced independent review of postal rates and had the laudable goals of protecting postal customers against undue discrimination while restricting cross-subsidies. However, the Commission stated that the current rate-setting structure should be abolished so that these goals can be accomplished more efficiently and effectively, by establishing an incentive-based rate-setting system. We agree that major changes are needed in this area. As we have testified, improvements in the postal rate-setting structure will be a fundamental component of a comprehensive transformation.[19] The existing statutory structure is increasingly ill suited to meeting the needs of the Postal Service and the American people. Its shortcomings include the following:

- Lengthy and burdensome rate-setting proceedings - The Commission found that the current rate-setting structure imposes a litigious, costly, and lengthy rate-setting process that can delay needed new revenues by more than a year. We agree. The Service and other stakeholders report spending millions of dollars in each rate case on attorneys, economists, statisticians, and other postal experts who pore over many thousands of pages of testimony, interrogatories, and rebuttals. The high cost of participation, coupled with the increasing complexity of rate-setting data and methods, make it difficult for smaller stakeholders to effectively participate in the regulatory process.

- Bias toward adversarial relationships - As the Commission noted, every significant change requires a major proceeding that places the Postal Service in an adversarial relationship with its major customers and at a distinct competitive disadvantage. Rate cases tend to pit the Service and many postal stakeholders against each other, since the zero-sum nature of the revenue requirement provides powerful incentives for parties to attempt to shift postal costs in ways that serve their immediate self-interests. The adversarial rate-setting process has

[19]GAO-03-812T.

consumed the attention of all of the parties involved, increasing the difficulty of focusing on constructive efforts to find mutually acceptable approaches to difficult technical issues. During lengthy rate cases, rules against ex parte communications help preserve due process and fairness, but also make it difficult for rate-setting experts at the Service and the PRC to constructively discuss technical issues and resolve problems as they arise.

Despite these structural impediments, rate-setting experts at the Service and PRC have made some progress in improving communications in recent years, notably during the 1999 Data Quality Study on the quality of data used for rate-setting purposes, as well as during subsequent efforts to improve data collection systems.[20] We are pleased that the Service has convened periodic briefings with representatives of the PRC, the Service's Office of the Inspector General, and us, in which it engaged with the parties and provided detailed status reports on initiatives to improve rate-setting data systems. We are also encouraged that the Service has started to engage with the PRC in planning some improvements to its rate-setting systems, and we commend the Service for offering public briefings to provide additional transparency on modifications to key data systems. These efforts facilitate constructive dialogue on data quality issues, providing opportunities for the parties to make continuous progress as postal operations, technology, and data systems change.

- Perennial disagreements - Cost allocation issues have been debated for many years and are frequently a key reason why postal rate cases are so lengthy and litigious, since their disposition can directly affect postal rates. The statutory structure seeks to assure all parties due process by enabling them to raise whatever issues they wish, regardless of how many times the same issues may have been considered in the past. The Postal Service has a special opportunity to repeatedly raise issues by building them into its initial proposals for changes to postal rates. For example, the Postal Service and PRC have strongly disagreed on the allocation of mail processing costs in rate cases dating from 1997—to the point that two sets of postal costs are routinely prepared, one according to the Postal Service's preferred methodology and one according to the PRC's methodology. This situation epitomizes the downside of enabling parties to repeatedly litigate the same issues in the name of due process. Although the

[20] A.T. Kearney, *Data Quality Study* (Alexandria, Va.: Apr. 16, 1999).

Commission noted that interested parties should have an opportunity to participate in rate-setting matters, the need to address complex cost allocations in each and every rate proceeding conflicts with the Commission's vision of a streamlined rate-setting process that can swiftly resolve complaints about postage rates.

- Poor incentives for data quality - The current statutory model gives the Service opportunities to seek advantage in litigious rate-setting proceedings through its control over what data are collected and how those data are analyzed and reported. The PRC cannot compel the Service to collect data, or update data it has collected. The PRC also cannot subpoena data that the Service has collected. The 1999 Data Quality Study found that key postal cost data had not been updated for many years and were used regardless of their obsolescence. Although the Service has worked to address these and other deficiencies identified by the study, as noted above, it is fair to question why the regulatory process had enabled these problems to continue for so many years. Further, regarding the sufficiency of data in the recent negotiated service agreement (NSA) case, the Service provided no mailer-specific cost data corresponding to mailer-specific discounts, creating uncertainty regarding whether the discount was set appropriately in relation to the cost savings that the Service should be expected to achieve as a result of the NSA.

- Disputes over cost allocation - The Service is generally opposed to PRC proposals that would require the Service to provide more detailed annual information on postal costs and information on cost allocation methodologies used to produce that data. In support of its view, the Service has asserted that the current statutory structure generally limits the PRC to a reactive role in considering proposed rates and supporting information provided by the Service in rate and classification cases. This perspective contrasts with the Commission's vision of independent regulatory oversight in which the outcome cannot be unduly influenced through the selective provision of information to the regulator. To this end, the Commission recommended that the Service periodically report on the allocation of costs in accordance with form, content, and timing requirements determined by the Postal Regulatory Board, the recommended successor to the PRC.

- Lack of mailer-specific data - Looking forward, a key issue is what data on the mailer-specific costs, volumes, and revenues of the Postal Service, if any, should be provided to justify mailer-specific discounts that result from NSAs. The Service has generally opposed providing

such mailer-specific data in the future as overly burdensome, unwise, and impractical, in part because its cost measurement systems are geared to providing aggregate data at the subclass level. The PRC is currently reviewing what cost data should be provided to justify mailer-specific postal rates, and key stakeholders have filed conflicting testimony on the issues in this area.[21] Regardless of the outcome, it is reasonable to ask how the Service can effectively identify, prioritize, and negotiate mutually beneficial NSAs if little reliable data are available on the cost savings that the Service should realize as a result of the mailer-specific requirements of each NSA.

The above problems are well documented. They have been cited in numerous independent reviews over the years, including some by us. The parties are familiar with the status quo, and we suspect that the high stakes involved make parties understandably reluctant to make changes, particularly when the financial consequences are difficult to foresee. In recent public meetings held to discuss possible changes to the rate-setting process within existing law, the Service dismissed many of the suggestions that were made. Moreover, the Service and other stakeholders have reached no consensus about proposals for legislative reform. Therefore, the Commission was advocating bold action when it concluded that the current rate-setting process should be abolished and replaced with a more streamlined structure that continues to impose rigorous standards on rate setting, but does so without impeding the ability of Postal Service officials to manage and lead.

The Commission's report built on the legislative debate in which price cap regulation has emerged as a leading alternative to the current statutory model for regulating postal prices. Specifically, the Commission recommended that the existing system of setting postal rates be abolished and replaced with a price-cap system to regulate the rates of noncompetitive postal products and services, coupled with providing the Service with pricing flexibility for competitive postal products and services, subject to a rule against cross-subsidization. The Commission's proposed price-cap system is intended to enhance the Service's management flexibility to set rates within ceilings established by the Postal Regulatory Board, so that if the rate ceiling is appropriately constructed, the Postal Service will feel intense pressure to rein in spending and improve efficiency and productivity. A price-cap system

[21]See documents filed under PRC Rulemaking Docket No. RM2003-5, available at www.prc.gov.

could enable the Service to implement a strategy of smaller, more frequent changes in postal rates, as opposed to a strategy of more infrequent, significant increases.

The Commission's recommended price-cap system has some similarities with price-cap systems that were offered in successive postal reform bills introduced by Rep. John M. McHugh. These proposals were reviewed in numerous hearings, and the extensive record surfaced many issues and concerns. In our view, key questions include the following:

- Would a price-cap system provide the intended incentives for the Postal Service to maximize its financial performance, since the Service is a public institution that is not accountable to shareholders who hold stock and demand management accountability?
- Would a price cap provide incentives for the Postal Service to reduce the quality of service for captive customers? If so, what transparency and accountability mechanisms would be needed to ensure the quality of universal postal service?
- Could the Service use its flexibility to raise rates within the price cap to unfairly shift the burden of institutional costs away from competitive products and services and onto its most captive customers?
- Should postal rates be required to cover attributable costs? If so, at what level (e.g., mail class, subclass, rate category, etc.)?
- Could the Service generate sufficient revenues if its rates were constrained by a price cap? If not, under what circumstances, if any, should the Service be authorized to raise rates in excess of the cap? How can ratepayers be assured that it would not be too easy for the Service to obtain such increases, which would vitiate the intent of the price cap? What process should apply to such "exigent" rate increases?
- Would a price cap restrain the growth of postal wages? If so, to what extent and would such a result be desirable?
- How would a price cap system affect historic preferences that have been provided to certain mailers, such as mailers of nonprofit mail, periodicals, and library mail?

- How could the Postal Service redesign the rate and classification system, as it did through the 1995 reclassification case, if it were subject to a price cap?
- Would adopting a price cap system be too risky, given the problems that have surfaced in some price-cap models adopted by other regulated industries? How could flexibility be built into the price-cap system itself to minimize risk and handle "the law of unintended consequences?"
- Should provisions of a price-cap system be specified by the legislative process? If so, which features should be codified in statute and which should be left to the regulatory process?
- What issues should be considered in adapting price-cap regulation from other industries and foreign postal systems to the unique context of regulating postal rates in the United States?
- What transition features should be required, such as a "baseline" rate case, in order to successfully implement a price-cap system?
- Should a revised and streamlined cost-of-service model be considered as an alternative to abolishing the current rate-setting structure and replacing it with a new model? If so, what statutory changes should be considered? Would such changes prove sufficient to remedy the shortcomings of the current rate-setting structure?

As the above discussion demonstrates, the need for changing the postal rate-setting structure is clear. The current structure delays price changes through lengthy, contentious, and burdensome proceedings and has poor incentives for providing quality data. However, many questions remain about what changes should be made to the rate-setting process and the potential problems associated with those changes. Specifically, the option of adopting a price-cap model for regulating postal rates has emerged as a main alternative to a cost-of-service regulatory model but raises many issues that deserve thoughtful consideration. By its very nature, such fundamental change to the rate-setting system would necessarily entail substantial uncertainty, risks, and the possibility for further change to deal with unanticipated consequences. In this regard, the benefits and risks of adopting a price-cap system need to be carefully considered and weighed against the benefits and risks of the status quo. If the Service is to be limited to its core mission, the flexibility inherent in a price cap system could become a key management tool to successfully managing the transition to a leaner, more efficient postal system.

Rate-Setting Oversight

In our view, as long as the Service remains a federal entity protected by the postal monopoly, it is appropriate that the Service's ability to compete with the private sector be balanced with oversight and legal standards to ensure fair competition between the Service and private competitors. The Commission sought to create such a balance by recommending enhanced powers for the newly created Postal Regulatory Board, including a complaint process in which rates can be reviewed against statutory limits that provide for due process and resolution of the complaint within 60 days. Depending on the outcome, the regulator could order rate adjustments to bring rates into conformity with statutory criteria. In our view, clear lines of authority in this area must be established if the rate-setting process is to be streamlined and speeded up. A key issue for Congress to consider is whether the Commission's recommendations have struck the appropriate balance between flexibility and accountability. Another issue is what due process rules should be established in order to enable stakeholders to provide meaningful input and participate in rate-setting matters, including the right to appeal regulatory decisions.

The Commission also proposed requirements for worksharing discounts that are established based on the costs that the Postal Service is estimated to avoid as a result of mailer worksharing activities to prepare, sort, and transport the mail. Specifically, the Commission stated that a specific requirement should be "that no new workshared discount for a non-competitive product should exceed costs saved (including the present value of projected future costs saved) and that the Postal Regulatory Board should have the authority to conduct an expedited, after-the-fact review upon written complaint that such a discount is excessive." In that case, the Commission said the regulator should be authorized to perform an expedited, after-the-fact review upon written complaint to ensure discounts do not exceed savings to the Postal Service. These recommendations raise the issue of whether different standards should apply for new and existing worksharing discounts.

By way of background, worksharing discounts did not exist when the Service was created by the Postal Reorganization Act of 1970. Thus, there is little statutory guidance in this area except for the mandate for the PRC to consider—along with other factors—the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Service. Over time, the PRC developed a guideline for recommending worksharing discounts so that the estimated reduction in Postal Service revenues would equal the estimated reduction in its costs. The objective of this guideline is to create incentives for the lowest-cost provider to perform certain postal activities, which can be

either the mailer performing worksharing activities or the Service performing additional activities when mailers do not workshare. Because worksharing discounts have become an integral part of the rate-setting structure, a key issue is whether statutory guidance would be appropriate in this area; and if so, whether hard-and-fast rules for worksharing discounts should be established in law.

Because postal rate-setting is at the heart of proposals for comprehensive legislative reform, it is important for Members of Congress to be aware of the many issues and questions that have been raised in this area. We believe that some of the issues and questions that arise from the Commission's recommendations include the following:

- Should the break-even mandate continue to govern the postal rate-setting process, or should the Service be allowed to retain a certain amount of earnings?
- How would the proposed Postal Regulatory Board consider postal costing issues under the Commission's proposals, since the Commission would abolish the current mechanism used to resolve these issues on a case-by-case basis (i.e., litigation in postal rate cases)? Specifically, what process should govern regulatory decisions regarding the measurement, allocation, and reporting of postal costs and revenues? Should the regulatory body also be given the authority to compel the Postal Service to collect data, as some have suggested?
- Would meaningful after-the-fact review of changes in postage rates be difficult to accomplish within the recommended 60-day time frame for considering complaints? Should stakeholders also be given the opportunity to obtain information through a discovery process; and if so, would a longer time frame be needed to consider complaints? What due process rules should be established for stakeholder participation in rate complaints and other rate-setting matters?
- Should the Commission's recommendation to allow NSAs be adopted, and, if so, what specific criteria are appropriate in this area? Could NSAs create competitive harm, and, if so, what measures should be taken to mitigate this risk (e.g., prior review and other limitations)?

- If mailer-specific discounts are authorized, should data be required on the mailer-specific cost savings that the Postal Service expects to achieve? If so, how should the regulator balance its needs for such information with limitations relating to the practicality and burden of producing it?

- Is after-the-fact rate review incompatible with the need to ensure fair competition by an organization that can leverage the revenues and infrastructure obtained through its monopoly on delivering letter mail? If not, should measures be taken to limit the potential for unfair competition, such as providing limitations on the introduction of subsidized new products and services? Should the regulator be authorized to order the discontinuance of postal products and services that consistently fail to cover their costs?

- Would the complaint process, as the only means for stakeholders to seek to alter postal rates under the Commission's proposals, create an incentive for numerous complaints that could become a de facto review of virtually all postal rates?

- Even if a regulator could order changes in rates after-the-fact, would it be reluctant to exercise that authority, given the potential financial impact and disruption for the Service and the mailing community?

- The Commission's report did not address whether the proposed Postal Regulatory Board could be held accountable for its actions in the rate-setting area through appellate review. Should the Postal Regulatory Board's actions be subject to appellate review, and if so, under what criteria?

- Another potential issue is whether a transition period would be needed to successfully implement a vastly different rate-setting system similar to what the Commission has recommended. For example, would a transition period be needed to enable the proposed Postal Regulatory Board to address major unresolved cost allocation issues, as well as for the Postal Service to make improvements to its cost allocation methods and underlying data systems that collect information for costing purposes?

The Need for Progress on Rate-Setting Issues under the Current Structure

The Service and the PRC continue to have long-standing disagreements on rate-setting issues that have added to the length, cost, and burden of litigating rate cases. These issues have been a major focus of contentious rate proceedings, and, if left unresolved, will likely be re-litigated in the next rate case. As noted previously, a key unresolved issue is the

allocation of mail processing costs, which has implications for most postal rates since the Service's mail processing and distribution network handles most mail. Specifically, the Service and the PRC disagree over the extent to which mail processing costs vary with mail volume and thus can be allocated to various mail categories, as opposed to being classified as institutional costs (i.e., overhead costs that the Service incurs regardless of mail volume). This disagreement has generated thousands of pages of evidence in rate cases and disagreements over the underlying assumptions, data, and analytic techniques. Although the arguments on both sides are rather arcane, the resolution of this dispute could have important practical consequences for postal rates and worksharing discounts. The estimated savings resulting from worksharing discounts—which is a key basis for establishing these discounts—is reduced as more mail processing costs are classified as institutional costs, since such costs do not vary regardless of how much mail is processed. Thus, the rates that apply to workshared mail, which accounts for three-quarters of total mail volume, could be affected by the resolution of this technical dispute.

In our opinion, the gap between rate cases provides a rare opportunity for the parties to take a fresh look at the issue of mail processing volume variability. Key postal cost dynamics have changed in recent years, including the shift from increasing to decreasing mail volume, the prospect for further declines in First-Class Mail volume, and the Service's initiative to realign its mail processing and distribution network. Such changes create uncertainty about whether historical relationships between mail volume and mail processing costs continue to apply, since historically mail processing costs increased as mail volume increased and the Service expanded its mail processing infrastructure incrementally. We urge the parties to reconsider their reliance on formal litigation so that this issue can be addressed before the inception of the next rate case. Progress in this area could diminish the burden on the Service and other stakeholders who participate in rate cases. In this regard, we note that the parties have worked hard to reach negotiated settlements to the last rate case and several other rate and classification proceedings since then. Given these outcomes, it is reasonable to expect similar progress in the area of mail-processing volume variability if the parties have the will to resolve their differences. If the parties do not make progress, that will further indicate the need for a new rate-making structure, as the Commission has recommended, so that technical issues can be resolved in a more businesslike and expeditious manner.

Human Capital Issues

The Postal Service's human capital—its people—is critical to providing vital postal services to the American people and achieving a successful postal transformation. The Commission concluded that as valuable as the Postal Service is to the nation, its ability to deliver that value is only as great as the capability, motivation, and satisfaction of the people who make possible the daily delivery of mail to American homes and businesses. We agree. Only through the efforts of its workforce are more than 200 billion pieces of mail delivered, 6 days each week, to the American people. Thus, we agree with the Commission's conclusion that few of the reforms outlined in its report would be possible without the support and contributions of the Service's most mission-critical asset: its people. As we recently reported, an organization's people must be at the center of any transformation effort.[22]

For this reason, the Commission focused on serious, long-standing issues in the human capital area that impose both statutory and practical constraints on the transformation of the organization. The problems can be grouped into three areas: (1) poor labor-management relations characterized by poor communication, lack of trust, excessive grievances, and difficulty negotiating labor contracts; (2) difficulty controlling workforce costs, including issues of workforce size, flexibility, pay comparability, workers' compensation, and escalating benefits costs; and (3) inadequate incentives for individual performance and the need for a stronger linkage between individual and organizational goals. The Commission proposed important changes in each of these areas, some of which would require the commitment of the parties to address them in a constructive manner, and some of which would require changes to existing law. Given the central importance of the Service's human capital, all of these proposals deserve close scrutiny and a fair hearing, despite the strong negative reactions that have been voiced by some stakeholders. Rather than declaring such proposals to be politically off-limits, we encourage Congress and the parties to approach these issues with open minds to explore whether a package of changes can be made that is mutually beneficial to the Service, its people, and the public. Much has changed in this area over the past 30 years, and the time is right to consider what statutory structure would be appropriate to enable the

[22]U.S. General Accounting Office, *Results-Oriented Cultures: Implementation Steps to Assist Mergers and Organizational Transformations*, GAO-03-669 (Washington, D.C.: July 2, 2003).

Postal Service to incorporate best practices and improve working conditions for its employees.

Achieving Effective Labor-Management Relations Will Be Fundamental to Making Progress

We and others have reported that adversarial labor-management relations have been a persistent issue for the Service and its major labor unions and have been a root cause of problems in improving the Service's operational efficiency as well as improving its culture and the quality of work life. [23] Poor communications, lack of trust, an excessive number of grievances, and difficulty negotiating labor contracts have been at the heart of labor-management issues. Such problems have increased the difficulty in constructively working on difficult issues involving the size, flexibility, compensation, benefits, incentives, and culture of the workforce. We are encouraged by recent progress in this area, such as reports by union officials of better communications, sharp reductions in the number of outstanding grievances, and labor contracts that were successfully negotiated between the parties without the need for binding arbitration. However, progress has been uneven and much more work remains to be done. We agree with the Commission's bottom line that Postal Service management must repair its strained relationship with postal employees.

Historically, autocratic management, persistent confrontation and conflict, and ineffective performance systems often characterized the organizational culture on the workroom floor. These problems resulted in an underperforming organization with major deficiencies in morale and quality of work life; huge numbers of grievances with high costs for the Service and its employees; and protracted, acrimonious contract negotiations. In our past reports, we found that these conditions have existed over many years because labor and management leadership, at both the national and local levels, have often had difficulty working together to find solutions to their problems. Under these circumstances, it was difficult for the parties to develop and sustain the level of trust necessary for maintaining a constructive working relationship and

[23]The National Academy of Public Administration, *Evaluation of the United States Postal* Service, (Washington, D.C.: July 1, 1982); U.S. General Accounting Office, *Labor-Management Problems Persist on the Workroom* Floor, GAO-GGD-94-201A/B, (Washington, D.C.: Sept. 29, 1994); U.S. General Accounting Office, *Little Progress Made in Addressing Persistent Labor-Management Relations Problems*, GAO/GGD-98-1 (Washington, D.C.: Oct. 1, 1997); United States Postal Commission On a Safe and Secure Workplace, *Report of the United States Postal Commission On A Safe and Secure Workplace* (Washington, D.C.: Aug. 31, 2000); U.S. General Accounting Office, *Major Performance and Accountability Challenges*, GAO-03-118 (Washington, D.C.: Jan. 2003).

agreeing on major changes to maximize the Service's efficiency and the quality of work life.

Poor labor-management relations are incompatible with the Commission's vision of achieving a more positive and productive climate necessary for a high-performing organization with a culture of excellence. Such a culture change will require better labor-management relations in which the parties maintain open communications, develop trust, and are willing to take risks to achieve mutually beneficial results.

On the positive side, officials from some of the Service's unions have told us that they have seen improvements in labor-management relations in recent years. They cited examples of improved communication and collaboration at the national and local levels, including

- Quality of Worklife and Employee Involvement programs, in which union and management officials reportedly have successfully communicated and made progress on finding ways to improve efficiency and the work environment;
- Joint Contract Interpretation manuals, as well as training implemented jointly by labor and management officials, which are intended to prevent disputes as well as help resolve current disputes and the backlog of grievances; and
- An Ergonomic Strategic Partnership among the Occupational Safety and Health Administration (OSHA) and postal labor unions to improve workplace safety and reduce risk factors, particularly ergonomic-related hazards.

Reducing Grievances

As the Commission noted, employee morale is an essential element of an incentive-based culture, but is undermined when employee-management relations are acrimonious. We agree with the Commission that the high number of remaining grievances and the large backlog of grievances pending arbitration are an indication of strained relations between postal managers and workers, to the detriment of morale, productivity, and, ultimately, service to ratepayers. As the Commission concluded, satisfied employees are of far more value to the nation's postal endeavor than those in a contentious relationship with their employer. Thus, we agree with the Commission that it is imperative that the Service give clear direction that settlement of problems and cooperative labor-management relations are a

priority. Rather than allowing problems to fester on the workroom floor, better communications and improved working relationships are needed to resolve problems as they arise, minimizing the need to resort to the grievance process to resolve disputes. This will require greater accountability for both supervisors and those they supervise, as well as for top management. We agree with the Commission that the Service must hold managers accountable for any behavior that results in poor labor-management relations, and we believe this principle should apply equally to employees at all levels of the organization.

The Commission noted that encouraging progress is being made by the Service and the National Association of Letter Carriers in resolving grievances using a restructured and streamlined grievance process. It recommended that such progress be used as a model, with the Service working diligently with other unions to institute procedures aimed at reducing the time to process grievances and the number of grievances appealed to arbitration. Recognizing that the success of any process depends on the collective commitment of the parties, we encourage the Service and its unions to make continued progress in this area.

Difficulty Negotiating Labor Contracts

Since postal reorganization, the Service and its major labor unions have often found it difficult to negotiate labor contracts without resorting to binding arbitration. The Commission criticized the collective bargaining process as overly lengthy and litigious, providing few incentives for the parties to reach negotiated settlements. It made detailed statutory recommendations to improve the process, including mandating the use of a "mediation and arbitration" approach and specific deadlines for completing various process steps and accelerating final resolution period. Postal union officials have strongly opposed these recommendations, stating that the parties have used the "mediation and arbitration" approach in the past and have the flexibility within existing law to mutually agree on any process for contract negotiations. Union officials have also said that existing deadlines are already difficult to meet, in part due to scheduling difficulties involving the availability of mediators and arbitrators. In their view, success is dependent on "people" issues, including good working relationships, communications, and trust, rather than on the formal process. They also have noted that the current contracts between the Service and three of its four major postal labor unions were negotiated without the use of an arbitrator and asserted that these outcomes demonstrate that progress has been made within the existing structure. We recognize these points, but believe that, as with other human capital

issues, the time has come to re-examine all aspects of a structure that was developed more than 30 years ago.

Difficulty Controlling Workforce Costs

Progress on controlling human capital costs will be critical to efforts to achieve "best execution" to sustain affordable universal postal service and to enhance the value of the mail. The Postal Service employed about 829,000 people at the end of fiscal year 2003, whose pay and benefits accounted for more than three-quarters of the Service's expenses. In this regard, we note that a recent analysis prepared by PRC staff showed that for the period between fiscal years 1998 and 2002 postal wage costs increased by 3.3 percent over inflation and postal benefits costs rose 28.1 percent over inflation. The Commission concluded that the size of the workforce largely determines its costs, observing that it will be critical for management and labor to work together constructively to determine the right size of the postal workforce and to ensure appropriate flexibilities in its deployment. As we have previously reported, nearly half of the Service's career workforce will reach retirement eligibility by 2010, creating an opportunity for the Service to gain resource flexibility through the attrition of retiring employees, while also minimizing disruption to its workforce.

We note that the Postmaster General initiated a constructive working relationship between national postal management and the leadership of its labor unions and management associations to deal with issues of mail security after anthrax was found in the mail. Such communication and partnerships cannot be legislatively mandated. However, better working relationships would help the Service and its employee organizations address difficult workforce size and flexibility issues in a manner that would allow the Service to rightsize its workforce in the least disruptive manner possible, including the ranks of both managers and their employees. All issues should be on the table, including work rules that constrain greater efficiency; working conditions that constrain the treatment, morale, and discretionary effort of the workforce; and constraints on having the most effective and efficient provider perform postal activities, including limitations on outsourcing.

Unresolved Pay Comparability Issues

We agree with the Commission's conclusion that the most thorny issue in collective bargaining today is pay and benefit comparability. Although the parties disagree about whether a wage and benefit premium exists and about the basis for making these comparisons, the Service's ability to control costs in this area will be critical to achieving a more efficient

organization. As we have previously testified, one of the limitations in the existing collective bargaining process is that the interests of all postal stakeholders, such as ratepayers, do not appear to have been sufficiently considered.[34] The Commission recommended that the Postal Reorganization Act be amended to clarify the term "comparability" and that the new Postal Regulatory Board should be authorized to determine comparable total compensation for all Postal Service employees. These recommendations have been strongly opposed by the Service's major labor unions, variously opposing them as "draconian" measures that would "destroy" collective bargaining for postal workers. The unions have also questioned why a regulatory body headed by three political appointees should have the power to effectively set a cap on postal wages.

With respect to clarifying the comparability standard, one option could be to revisit the guiding principles incorporated into the statutory wage and comparability standard so that it would more fully reflect all stakeholder interests and the Service's overall financial condition and outlook. These principles could specify that comparability includes total wage, compensation, and benefit costs, as well as the relationship of these costs to total costs, their impact on rates and revenues, and the Service's overall financial condition. Another option could be to delete pay comparability provisions from the statute, as some postal union officials have suggested. This option would raise the issue of what, if any, standard would remain to guide negotiators and arbitrators in the collective bargaining process.

With respect to shifting authority over total postal compensation to a newly created regulatory body, we note that this change would appear contrary to the Commission's principle that the Service needs additional flexibility to manage its operations. A related issue is how the Service will be able to pay competitive compensation for certain skills. We also question why a second body—in addition to the system of third-party arbitration—should be added to the already complex processes for determining postal pay and benefits. Thus, it is not clear whether this recommendation would add value to the collective bargaining process.

Another controversial Commission recommendation was that the Postal Service pension and postretirement health benefit plans should be subject to collective bargaining—meaning that the Service and its unions should have the flexibility to develop new plans that are separate and apart from

[34]GAO-03-812T.

existing federal pension and retiree health benefit plans. The Commission recognized that such a change could have an uncertain impact on the entire federal pension and retiree health benefit programs. Although the Service may have the authority under existing law to withdraw from the federal health program for its current employees under certain circumstances, it would still be required to contribute to the health costs of its current retirees. The Commission recommended that the Service work with the Department of the Treasury, the Office of Personnel Management (OPM), and other pertinent parties to determine the potential impacts that separate funds would have. Because these recommendations could have major effects on all federal employees, much more information would be needed in order to determine the potential impact of statutory changes in this area on the federal budget and employees. It is also not clear whether, as a practical matter, expanding the scope of collective bargaining to all postal benefits would result in cost savings for the Postal Service. For example, where the Service has flexibility, the Service has agreed in collective bargaining agreements to pay a higher percentage of health insurance premiums for its employees as compared to other federal agencies (about 85 percent vs. up to 75 percent).

Addressing Retiree Benefits Obligations

We agree with the Commission that the Service's substantial obligations for its retirement-related benefits need to be addressed, including benefits for pensions and retiree health. Key issues include how to assign responsibility and structure a mechanism for covering the costs of providing retirement-related benefits and how the accounting standards should be applied. In addition, concerns have been raised about how changes in funding these obligations could impact the federal budget, as well as postal ratepayers.

The recently enacted law (P.L. 108-18) changed the method by which the Service funds the Civil Service Retirement System (CSRS) pension benefits of its current and former employees to prevent a projected overfunding from materializing, while at the same time shifting responsibility for funding benefits attributable to military service from taxpayers to postal ratepayers. The law also required that, beginning in fiscal year 2006, the difference between the Service's contributions under the new and old funding methods—the "savings"—be held in an escrow account until the law is changed. To facilitate consideration of which agency—the Postal Service or the Treasury Department—should fund military service costs, the law required the Postal Service, the Office of Personnel Management, and the Treasury Department to each submit

proposals to the President, Congress, and the GAO by September 30, 2003. The law also required the Postal Service to submit a proposal to the same recipients on how it planned to use the future "savings." We, in turn, have until November 30, 2003, to analyze these proposals and will provide our reports to Congress before Thanksgiving.

The Service submitted two proposals for use of the "savings," both of which would affect postal rates to varying degrees.[35] The first proposal recommends that the Service be relieved of the burden of funding benefits attributable to military service, and that the Service, in turn, would prefund its retiree health benefits obligations for current and former employees, which has been estimated at approximately $50 billion. This proposal is consistent with the Commission's recommendation that responsibility for funding CSRS pension benefits relating to the military service of postal retirees should be returned to the Department of the Treasury. The second proposal is based on the premise that the Postal Service will remain responsible for funding military service benefits as currently required by P.L. 108-18. Under this proposal, the Service said that it would fund its retiree health benefits obligations only for its employees hired after fiscal year 2002 and use the remaining "savings" in priority sequence, to repay debt; and to fund productivity and cost-saving capital investments. This proposal appears consistent with the Commission recommendation that the Service should consider funding a reserve account for unfunded retiree health care obligations to the extent that its financial condition allows.

There are a number of key questions related to the Service's proposals that we are considering as part of our mandated review, including

- What is the relationship of military service to federal civilian service and benefits?
- What have been the historical changes to the funding of CSRS benefits to Postal Service employees and retirees?

[35]The Service has estimated that the additional rate increase impact in fiscal year 2006, above any inflationary increase, would be 2.0 percent under its first proposal and 0.3 percent under its second proposal.

- What correlation exists between the cost attribution and funding methods of the Federal Employees Retirement System (FERS) and the current CSRS methods applicable to USPS?
- How have other self-supporting agencies funded CSRS benefits?
- What are the various options for allocating military service costs?
- What would be the effects of the Service's proposals on the unified federal budget? On ratepayers? On the Service's overall financial situation and transformation efforts?
- What alternatives exist for funding health benefit obligations to existing postal retirees and employees and distributing that responsibility between current and future ratepayers?
- What issues need to be addressed regarding the Service's accounting treatment of retiree benefit obligations?
- What are the potential consequences to the Service and postal rates should the Service be required to make payments, beginning in fiscal year 2006, into an escrow account without the authority to spend the escrowed funds for postal purposes?

Reforming Workers' Compensation

Another benefit area where costs have been difficult to control is the Service's workers' compensation benefits.[26] The Commission found that under the Federal Employees' Compensation Act (FECA), the Service has maintained a broad and effective workers' compensation program and that recent efforts have lowered injury rates considerably. However, the Commission also concluded that the Service, given its unique status, should be provided relief from FECA provisions that were creating costly unintended consequences. The Commission recommended making the Service's workers' compensation program more comparable to programs in the private sector in order to control costs, provide adequate benefits, and address the Service's unfunded liability of $6.5 billion in this area. We

[26]U.S. General Accounting Office, *Recent GAO Reports on the Federal Employees' Compensation Act*, GAO/T-GGD-97-187 (Washington, D.C.: Sept. 30, 1997); *Federal Employees' Compensation Act: Issues Associated With Changing Benefits for Older Beneficiaries*, GAO/GGD-96-138BR (Washington, D.C.: Aug. 14, 1996).

believe that placing workers' compensation benefits on a par with those in the private sector merits careful consideration.

Inadequate Performance Incentives

As the Commission pointed out, a key goal of human capital reform should be to establish an incentive-based culture of excellence. We have reported that leading organizations use their performance management systems to accelerate change, achieve desired organizational results, and facilitate communication throughout the year so that discussions about individual and organizational performance are integrated and ongoing.[27] Modern, effective, and credible performance appraisal systems are a key aspect of performance management. The Commission concluded that the level of success achieved by the Postal Service will hinge on its ability to successfully deploy and motivate a talented, capable, nimble workforce of a size appropriate to the future postal needs of the nation and to give its employees a personal stake in the success of the institution's ambitious goals.

In this regard, we have reported that the need for results-oriented pay reform is one of the most pressing human capital issues facing the federal government today.[28] Successful implementation of results-oriented pay reform, commonly referred to as "pay for performance," requires modern, reliable, effective, and as appropriate, validated performance management systems. Such systems need adequate safeguards, including reasonable transparency and appropriate accountability mechanisms. In fiscal year 1995, the Service implemented a pay-for-performance system for its executives, managers, postmasters, supervisors, and other nonbargaining employees. This system was discontinued in fiscal year 2002, in part because of concerns that large payouts were made when the Service was recording large deficits. The Service revised its merit-based pay program for its executives and officers in fiscal year 2002 and revised its merit-based pay program for its postmasters, managers, and supervisors in fiscal year 2004.

[27]U.S. General Accounting Office, *Results-Oriented Cultures: Using Balanced Expectations to Manage Senior Performance*, GAO-02-966 (Washington, D.C.: Sept. 27, 2002).

[28]U.S. General Accounting Office, *Results-Oriented Cultures: Modern Performance Management Systems Are Needed to Effectively Support Pay for Performance*, GAO-03-612T (Washington, D.C.: Apr. 1, 2003).

Given the concerns that led to the overhaul of the Service's previous merit-based pay systems, it is important that these systems be evaluated to ensure that they are administered fairly and provide meaningful incentives. Such incentives would require valid measures that correspond with individual and organizational performance goals, as well as targets that are sufficiently challenging that they are not met automatically. For example, any productivity-based measures should result in real and measurable savings.

In addition, as we have reported, proposed changes to the Senior Executive Service could provide a model for better linking pay and performance of senior executives.[29] For example, the proposed Senior Executive Service Reform Act of 2003 includes a number of important reforms that would increase the pay cap for senior executives while also linking their pay more closely to performance. Similar issues would appear to apply to lifting the statutory pay cap for postal executives.

Over the years, the Service's major labor unions have consistently opposed extending a pay-for-performance system to craft employees. Presidential Commissioner Norman Seabrook shared their concerns, stating that in practice, pay for performance systems are characterized by nepotism, favoritism, and horrible morale among the workers. Union concerns also include tying employee compensation to results that depend in part on external events beyond their control as well as on the quality of postal management. It is reasonable to question whether a pay-for-performance system could be agreed on, implemented, and successful in the face of strong opposition of national and local union leaders. Union concerns are understandable because past history has led some union officials to question whether a pay-for-performance system could be successfully implemented.

Nevertheless, as the Commission pointed out, properly designed performance-based compensation can serve as a powerful communications and motivational tool, helping employees understand how they can contribute to the Service's financial health and success—and be rewarded for their efforts. In our view, aligning the interests of individual workers with the specific performance goals of the Service will be essential for the future. As the Commission concluded, the desire of the

[29]U.S. General Accounting Office, *Human Capital: Building on the Current Momentum to Address High-Risk Issues*, GAO-03-637T (Washington, D.C.: Apr. 8, 2003).

workforce to make the modernization of the nation's postal network a success, along with its willingness to make possible the Service's ambitious goals to rein in costs while improving productivity and service, will in no small part determine the success or failure of the entire transformation endeavor, and, ultimately, the fate of universal service at affordable rates.

As the above discussion illustrates, human capital reform is necessary, but many issues remain to be resolved. We believe that key questions for Congress to consider include:

- What statutory changes can be made that would provide additional incentives for the Service, its employee organizations, and its employees to resolve their differences in an appropriate and expeditious manner, including through the grievance process and at the bargaining table? What opportunities exist to facilitate better communication, streamline lengthy processes, and minimize their cost?

- Should the existing statutory standards for comparability of postal wages and benefits be clarified to include specific performance criteria and factors upon which a comparison must be made, such as the Service's overall financial condition and outlook?

- If comparability standards are retained, should they be enforced by an outside regulatory body or should they be considered self-enforcing through the collective bargaining process?

- What practical consequences could be expected if all postal benefits, including all health and retirement benefits, became subject to the collective bargaining process? What would be the potential effects on the financing of benefits for employees of both the Service and the rest of the federal government? Could increases in postal benefits costs also be expected over time, given the Service's history of agreeing to pay a larger share of insurance premiums than other federal agencies pay?

- Should workers' compensation benefits for Service employees be greater than those generally available to private sector employees? What opportunities exist to provide incentives to minimize workers' compensation costs?

- Should the statutory pay cap on postal executives be lifted, and, if so, how would executive pay be linked to performance? Would increased accountability apply to postal executives for individual and organizational results, particularly when problems arise? What

disclosure of postal executive compensation—including bonuses and other forms of compensation—would be appropriate to incorporate best practices that have been put into place in the private sector?

The Postal Service Needs to Maximize Progress within Its Current Legislative Structure

While the Commission made a number of recommendations that require legislative changes, it also made suggestions for improving efficiency and service that can be implemented under the current law. These recommendations centered on standardizing and streamlining the postal network, both the processing and distribution infrastructure and retail facilities, with major efficiency gains accruing from changes in the processing and distribution network. The Commission commended the Postal Service for undertaking an ambitious effort, the Network Integration and Alignment project, to rationalize the processing and distribution network. We agree that this project could exert meaningful influence on the Service's efficiency, but we have concerns about the lack of publicly available information on the Service's plans and related funding strategies in this area. The Commission also pointed out that better postal data would aid the Service's efforts to increase efficiency. We believe that the availability, accuracy, and relevance of postal data should be central to any meaningful transformation effort.

The Commission recommended a core philosophy for an improved national mail service—the concept of best execution. This concept, as described by the Commission, includes employing corporate best practices in all operations, as well as selecting the provider who can perform the service at the highest level of quality for the lowest cost. Best execution has important implications for the Postal Service because it means that the Service should consider who could perform the work best, postal employees or private sector providers, when considering outsourcing and expanding worksharing opportunities. Some postal union officials have stated that the Service can provide better execution than private sector providers. While this may be true, best execution may be difficult to realize under the existing environment due to

- lack of incentives to perform at the highest level possible;
- an outdated, inefficient infrastructure; and
- insufficient data to assess the true cost of operations.

We have addressed the issue of lack of incentives in a previous section. In the next sections we will discuss the importance of economy and efficiency in the postal network and related data issues.

Factors That Hinder Economy and Efficiency in the Postal Network

The Commission characterized the current postal network as too costly, too inefficient, too large, and lacking standardization. It envisioned a streamlined, standardized network capable of delivering universal service in the most efficient and cost-effective manner possible. We believe this vision is achievable if approached in a comprehensive, integrated fashion, and supported by postal stakeholders. However, practical impediments may hinder the Postal Service from rightsizing its infrastructure. Historically, the Service has encountered resistance from employees, mailers, communities, and Congress when it attempted to close facilities. Proactively working with stakeholders to garner input and support for its infrastructure initiatives may address legitimate concerns and thereby alleviate some of this resistance. Another impediment has been the Service's limited options for funding capital improvements. Earlier we discussed how retained earnings could increase the Postal Service's funding flexibility. However, this change would require legislative action. If the Service is to achieve best execution, it should increase current efforts to address problems with its infrastructure. The Service also needs to identify its funding needs for implementing its plans in this area. For purposes of our discussion we have separated the postal infrastructure into two distinct, yet inter-related, areas: (1) the network of post offices and other retail facilities and (2) the network of mail processing and distribution facilities.

Difficulties in Optimizing the Postal Retail Network

The Commission concluded that the Service needs to constructively address the fact that many of the nation's post offices are no longer necessary to the fulfill the universal service obligation. We understand that making changes to retail operations is often controversial because communities do not like to lose their local post offices and changes in this area are often perceived as a reduction in services. Unfortunately, the Postal Service has not done enough to inform the public of the many retail options currently available. Currently there are over 70,000 locations where stamps are sold, such as ATMs, grocery and other retail stores, and postal vending machines. Stamps can also be purchased via the Internet, through the mail, or from rural carriers. In addition, the Service is extending retail access to 2,500 self-service kiosks and Hallmark Gold Crown card shops. Yet, about 80 percent of all stamp revenue is still generated at the retail counter. Two Commission recommendations in this area that we concur with were: (1) the Service should dramatically

escalate its efforts to increase alternative access to postal services, and (2) the Service should market these alternatives more aggressively.

We believe that the Service should strive to improve accessibility to postal retail services as it implements its strategy of rationalizing its retail network, including closing post offices. The Service's Transformation Plan stated that the Service would create new, low-cost retail alternatives to extend the times and places that its services are available, including self-service, partnerships with commercial retailers, and Internet access to retail services. The plan said that the Service has begun a retail network optimization process, in which redundant retail operations would be consolidated, starting with poor-performing contract postal units, and replaced with alternative methods of retail access. The optimization process involves a national retail database that is to be used with a criteria-based methodology for modeling retail optimization and restructuring scenarios. The Service has also said it intends to expand retail service in markets where it is underrepresented, while reducing retail infrastructure in markets where it is overrepresented.

Under current law, the Service is not allowed to close post offices for economic reasons alone. The Commission recommended that legal restrictions that limit the Service's flexibility in this area be repealed and that the Service be allowed to close post offices that are no longer necessary for the fulfillment of universal service. While we agree that the Service should have the ability to align its retail network with customer needs in order to fulfill its universal service obligation in a cost-effective, efficient manner, we also believe that the Postal Service must assure Congress that the alignment will be done in a fair, rational, and fact-based manner.

In contemplating the Commission's recommendation to repeal the post office closing law, we have identified the following key questions:

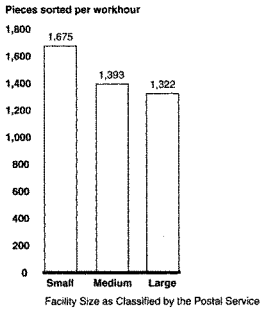
- What national standards, if any, should apply to universal access to postal retail service?
- What criteria and process should be used to realign the Service's retail infrastructure?

- Should the Service have greater freedom to reshape its retail infrastructure, or should Congress have involvement in such decisions, possibly by using a model such as the military base-closing process to close post offices that are no longer needed?
- Should current statutory restrictions on closing post offices be retained, modified, or repealed?
- What transparency and accountability is appropriate in this area?

Difficulties in Optimizing the Postal Processing and Distribution Network

The Commission found that the Service's processing and distribution network is plagued with problems, including lack of standardization, inefficiency, and excess capacity. The Service has approximately 500 facilities dedicated to processing the mail that do not share a standard footprint for architectural design, equipment complement and layout, or mail processing procedures. The lack of standardization may be one of the contributors to variations in productivity among mail processing facilities. Smaller facilities, as measured by volume, number of employees, and physical space, tend to have higher productivity, which is a possible indication of diseconomies of scale. For example, on average, small facilities tend to handle more mail, relative to work hours expended, than large facilities (see fig. 3). Standardizing operations across facilities may minimize diseconomies of scale and should be considered as part of planning plant consolidations or closings. In addition, standardization of processing and distribution facilities is widespread in process-oriented industries where standardization is viewed as vital to increased flexibility and efficiency. It may be difficult for the Service to become a world-class organization without establishing a standard footprint throughout its processing and distribution network.

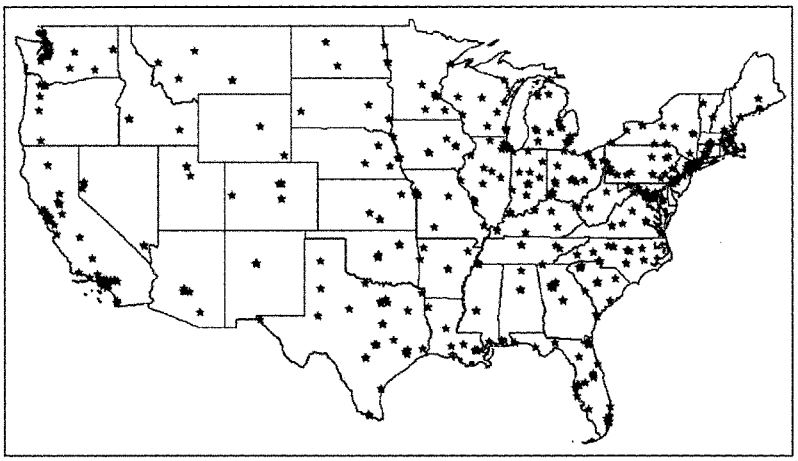
Figure 3: Productivity of Mail Processing Plants, by Facility Size, in Fiscal Year 2001



Source: Postal service data; GAO analysis.

In addition to the lack of standardization, the Service's processing and distribution facilities may not be optimally located. To a large degree, the processing and distribution network has evolved gradually in response to volume growth. Figure 4 shows the location of the Service's processing facilities in the continental contiguous United States. Distributing mail between these facilities utilizes thousands of transportation lanes and results in too many partially full trucks traveling between plants. Better utilization of trucks and lanes may save the Postal Service money and, if properly executed, could improve service.

Figure 4: Location of Postal Service Mail Processing Facilities



Source: GAO based on Postal Service data.

Another issue raised by the Commission related to the processing and distribution network is the assertion that the Postal Service has too many facilities, and the ones it has are not always used effectively, resulting in excess capacity throughout the network. Excess capacity can be very costly as it may require increased maintenance, facility, and labor costs. With changes in the types and volumes of mail and advances in both processing and information technology, the current network may be too large. We caution, however, that any consolidation plan should consider the effects of potential diseconomies of scale. Consolidating small facilities that may be more efficient into inefficient large facilities may not achieve the desired cost savings or service improvements. To achieve sustained cost savings, the Service will need to take a critical look at how to standardize and rightsize the processing and distribution network to maximize efficiency. As we have previously reported, any effort to rationalize the Service's processing network must also take into

consideration the increased safety and security needs created by the anthrax attacks and the proper extent and location of mail safety equipment.[30] Other considerations also include how network realignment could affect the need for a mix of workforce skills and abilities, as well as workforce diversity and demographics.

No Public Plan and Limited Stakeholder Engagement on Network Rationalization Strategy

The Commission noted the importance of the Service working with stakeholders to successfully implement best execution strategies, streamline the postal network, and decide the fate of unnecessary postal facilities. We agree. However, to date, the Service has not made public a comprehensive infrastructure rationalization plan and has had limited engagement with stakeholders who may be affected. Such a plan should lay out the Service's vision and how it plans to reach it, including the criteria, process, and data it uses to make its decisions. In our view, the lack of this type of information will likely lead to suspicion and lack of trust about the objectivity, fairness, and impartiality of Service decisions and the lack of input from stakeholders could prevent the Service from achieving the goal of a more efficient network. Further, we believe that it is essential for the Service to engage its stakeholders in its plan development process to address legitimate concerns and minimize disruption, thus alleviating some of the resistance that is often encountered when the Service tries to close facilities.

A comprehensive network integration and rationalization plan will be important for Congress to have regardless of whether a commission is established to consider network rationalization. One of the most important deliverables in the Service's Transformation Plan, the Network Integration and Alignment (NIA) project, is a set of processes and tools used to analyze the optimal number, locations, and functions of mail processing and transportation facilities. The NIA strategy was to have been developed by the fall of 2002. The Service did not meet this time frame, and the Commission has reported that the Service hopes to begin putting the new strategy into effect at the end of this year. It has already begun to close some types of facilities and build others, without disclosing how these activities fit into the NIA strategy.

To succeed in optimizing its networks, the Service must work with its key stakeholders, including employee organizations, the mailing industry, affected communities, and Congress. However, based on difficulties it has

[30]GAO-03-812T.

encountered in the past, the Service appears to be reluctant to divulge its network optimization plans, including the timing and funding needs associated with these plans, to Congress or its stakeholders. We believe that the Service will face more resistance if it approaches transformation in an insular, incremental fashion. For example, some union representatives have acknowledged that the Postal Service needs to rationalize its infrastructure, and they have committed to working with the Service to achieve this goal. However, they have received limited information to date concerning the Postal Service's plans for closings and consolidations. Likewise, various mailers have expressed concern that the Postal Service does not adequately seek input regarding customer needs when planning major changes. This concept is anathema to best practices employed in private sector service industries.

Recognizing the difficulties the Service has experienced in rationalizing its network, including closing unneeded facilities, the Commission recommended that Congress establish a Postal Network Optimization Commission (P-NOC), similar to the base-closing model and provisions in proposed postal reform legislation introduced by Senator Carper. The P-NOC would be charged with making recommendations to Congress and the President relating to the consolidation and rationalization of the Service's mail processing and distribution infrastructure. Under the Commission's proposal, P-NOC recommendations would become final unless Congress disapproves them in their entirety within 45 days. The intent of this recommendation corresponds with our observation that a base-closing model may prove necessary to address politically sensitive changes to postal facilities.

Regardless of whether or not a P-NOC is implemented, the following three key factors will be needed to guide decisions:

- principles for rationalizing infrastructure that are fact-based, clearly defined, and transparent;
- players who should be involved in making the decisions; and
- processes that should govern how decisions are made and implemented.

Identify Funding Needs and Strategies

To accomplish major transformation, the Service will need to identify its funding needs related to its major transformation initiatives and its strategies for funding these initiatives. Historically, postal policy has been to fund capital expenditure as much as possible through cash flow from

operations, with shortfalls financed through debt. By law, the Postal Service's total debt cannot exceed $15 billion, and annual increases in the Service's outstanding debt cannot exceed $3 billion. In fiscal year 2001, the Service was faced with insufficient cash flow from operations and with debt balances that were approaching statutory limits. Consequently, the Service imposed a freeze on capital expenditures for most facilities that continued through fiscal years 2002 and 2003. Implementing best execution strategies is difficult under these circumstances, especially since the Service has not specified what its funding needs will be to rationalize its infrastructure and implement other Transformation Plan initiatives. More information in this area would be useful for Congress and other stakeholders to understand the Service's future financial needs. It would also be useful for the Service to assess what funding it could receive from continuing to identify and dispose of surplus real estate.

The Commission recommended that the Postal Service be encouraged to include policy and goals related to the active management of its real estate in future strategic plans. Disposing of surplus real estate would not only save the Postal Service maintenance and repair expenses but may also provide a source of funds that can be used to finance capital projects. Furthermore, aggressive management of its underutilized real estate assets could also facilitate local redevelopment. In addition, passage of the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18) provided the Postal Service with some financial relief. Outstanding debt at the end of fiscal year 2004 is budgeted to be $2.6 billion to $3.1 billion, down from an estimated $7.3 billion at the end of fiscal year 2003 and $11.1 billion at the end of fiscal year 2002. We believe the Service has a window of opportunity for financing major infrastructure changes that may not last long if First-Class Mail volumes continue to decline. Taking advantage of this opportunity could better position the Service for the future.

Opportunities to Strengthen Information Technology Investment Management

As the Service has recognized, improving its information technology (IT) infrastructure should be considered as part of any network rationalization project. We share the view of the Commission that transformation should include enhanced information systems because streamlined and integrated operations will require a strong IT infrastructure. The Service has a number of IT initiatives designed to enhance the efficiency of the processing and distribution network that are currently at various levels of deployment. Among these is the Intelligent Mail program, the Surface Air Management System, and the Transportation Optimization Planning and Scheduling system. While the Service's IT initiatives may provide enhanced IT capabilities, it is not clear how they will be integrated or when they will be fully deployed.

As we have previously reported, the Service has established significant capabilities for managing its IT investments, but shows mixed progress in managing its IT investments as a portfolio. The Service has not utilized criteria that adequately address cost, benefit, schedule, and risk so that it can effectively analyze, prioritize, or select its investments from a portfolio perspective. Also, the Service does not regularly evaluate completed projects and currently has no institutionalized processes that enable it to learn from its current practices and investments and from other organizations. Accordingly, the Service cannot ensure that it is selecting leading-edge IT investments that will maximize returns to the organization and achieve strategic change.[31]

Data Issues Related to Achieving Greater Efficiency

Accurate cost and performance data are the cornerstone of efficiency improvements and are vital if the Service is to achieve best execution. In this regard, the Commission noted that the Service could use better real-time information on the location of individual mail pieces and the containers they travel in to improve its efficiency, such as re-routing mail to less busy facilities to ensure its more rapid processing, as well as adjusting for weather conditions or vehicle breakdowns. In addition, to determine best execution, the Service would need to know how much each process, function, and operation actually costs to perform and how these functions interrelate. For example, when determining what portion of overall operations may be performed cheaper by the private sector, it would be necessary to know what the actual cost and quality of each function is and what the effect on overall costs and quality would be if this function were contracted out. Some unions, mailers, and other groups have raised concerns about the information used to make outsourcing decisions, as well as the accuracy of data systems used to measure performance and productivity.

Recognizing that it will need improved cost information, the Service reports that it is currently implementing an activity-based costing system in over 380 mail processing facilities, which is intended to provide specific data to managers to help them evaluate and reduce operational costs. In addition, the Service has continued implementing the recommendations of the 1999 Data Quality Study to improve key postal cost data. Data quality

[31]U.S. General Accounting Office, *United States Postal Service: Opportunities to Strengthen IT Investment Management Capabilities*, GAO-03-3 (Washington, D.C.: Oct. 15, 2002).

issues continue to be of interest to the House Committee on Government Reform, which has asked GAO to follow up on the Service's progress in this area. Others with expertise in postal data quality issues, such as the Postal Rate Commission and the Postal Service's Office of Inspector General, may have insights on costing and performance data necessary to address issues that have been raised by the Commission's proposals. Later this year, the Postal Rate Commission plans to host public sessions where staff from the Service will provide briefings on changes the Service has made to update data systems related to carrier costs and on recent changes in the Service's accounting and reporting systems. Such constructive exchanges help to further mutual understanding and progress on data quality issues. Continued focus on improving the quality of postal costing and performance data would also be necessary to successfully implement the Commission's proposals.

Conclusion

We and the Commission agree that the Service faces an uncertain future. Also, we agree that both congressional action on comprehensive postal reform legislation and continued actions by the Postal Service to make improvements under its existing authority are necessary to ensure the future viability of the Postal Service. The Commission's key conclusions, consistent with our past work, were that the Service faces financial pressure due to its outmoded business model, significant financial obligations, operating inefficiencies, electronic diversion and mail volume trends, and statutory and practical constraints. The Service's current business model is not sustainable in today's competitive environment. Thus, we believe that now is the time to "get it right" and modernize the statutory framework that governs the Service.

In addition to statutory reform, we agree with the Commission that the Service can and should do more within its existing authority to work toward "best execution" that incorporates corporate best practices and enables those who can perform best and for the best price to provide postal activities, whether that is the Service, the mailing industry, transportation firms, or other companies. The Service has many opportunities to become more efficient, such as by standardizing its operations and reducing excess capacity of its network. Impending retirement of much of the Service's workforce also creates an opportunity for the Service to realign its workforce through attrition. The Commission's vision of rightsizing the Service's infrastructure and workforce is achievable if approached in a comprehensive, integrated fashion, and supported by postal stakeholders.

However, since the Service issued its Transformation Plan in April 2002, it has not provided adequate transparency on its plans to rationalize its infrastructure and workforce; the status of initiatives included in its Transformation Plan; and how it plans to integrate the strategies, timing, and funding necessary to implement its plans. In addition, the Service has had limited constructive engagement with employee organizations, the mailing industry, affected communities, and Congress with regard to its efforts to implement its key transformation initiatives related to rationalizing its infrastructure and workforce. As the Service knows from the difficulties it has encountered when it has tried to make changes to its facility locations in the past, these decisions can be highly controversial. However, if those who are potentially affected by such decisions do not have sufficient information about how they may be impacted by proposed facility changes, the Service is unlikely to gain the necessary support to successfully achieve a much more efficient network.

Matter for Congressional Consideration

In view of the Service's continuing financial, operational, and structural problems, as well as trends that increase the urgency of making rapid progress in transforming its organization, we believe that Congress should consider the Commission's recommendations as well as GAO's reform suggestions and enact comprehensive postal reform legislation. Some of the key areas that need to be addressed as part of comprehensive reform legislation include clarifying the Service's mission and role; enhancing governance, accountability, oversight, and transparency; improving regulation of postal rates; and making human capital reforms.

Recommendation for Executive Action

To facilitate the Service's progress in implementing actions under the existing system, we recommend that the Postmaster General develop an integrated plan to optimize its infrastructure and workforce, in collaboration with its key stakeholders, and make it available to Congress and the general public. In addition, the Postmaster General should provide periodic reports to Congress and the public on the status of implementing its transformation initiatives and other Commission recommendations that fall within the scope of its existing authority. Postal officials have agreed to take these actions.

Chairman Collins, that concludes my prepared statement. I would be pleased to respond to any questions that you or the Members of the Committee may have.

Contact and Acknowledgments

For further information regarding this testimony, please call Bernard L. Ungar, Director, Physical Infrastructure Issues, on (202) 512-2834 or at ungarb@gao.gov, or call Linda Calbom, Director, Financial Management and Assurance, on (202) 512-8341 or at calboml@gao.gov for pension and retiree health issues. Individuals making key contributions to this testimony included Teresa Anderson, Gerald P. Barnes, Joshua Bartzen, Alan Belkin, Amy Choi, Margaret Cigno, Keith Cunningham, William Doherty, Brad Dubbs, Kathleen A. Gilhooly, Kenneth E. John, Roger Lively, Scott McNulty, and Lisa Shames.

Post-Hearing Questions for the Record
Submitted to the Honorable John Potter, Postmaster General
From Senator Tom Carper

"The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability"

November 5, 2003

1. As you are certainly aware, the U.S. economy grew by a surprising 7.2 percent in the third quarter of this year. I'm told that increased mail volume is usually a predictor of future economic growth. Did we see any increase in mail volumes in recent months? If not, is this an indication that electronic diversion is beginning to have more of an impact on the Postal Service? Will we see mail volumes bounce back if the economy continues to grow at the pace it has in recent months?

We have yet to see total mail volume rebound to growth. We expect that volume will recover, however, as the economy continues to strengthen. We anticipate that Standard Mail volume, in particular, will grow in 2004. Due to the continuing impact of electronic diversion, we do not think that First-Class mail volume will grow or, perhaps, will grow at a slower than historical rate. It is normal for mail volume to lag the economy by two quarters, so the fact that total volume has not yet grown does not mean necessarily that electronic diversion of mail is accelerating.

2. It is reported in the Postal Service's last Five Year Strategic Plan that the Postal Service will begin delivering more advertising mail than First Class Mail by October 2005. What does this mean for the future of the Postal Service? Will its financial health be even more dependent on the health of the overall economy? Will customers no longer see as much value in the Postal Service if it mostly delivers what they often consider junk mail?

It takes three pieces of Standard Mail to replace the financial contribution of one average piece of First-Class Mail lost from the mailstream. Thus, the most significant impact that the Postal Service will experience from the mail mix change noted in the question is that the Postal Service will lose the financial benefit of high contribution First-Class Mail. This is an important issue for the Postal Service because it has relied on growth in First-Class Mail to finance the continuously growing delivery network.

As you note, a mailstream that has a higher proportion of Standard Mail volume will be more sensitive to economic fluctuations. We believe that, in general, our customers value much of the Standard Mail they receive and will continue to value the postal system as the mail mix changes. Our customers rely on Standard Mail to facilitate the purchase of merchandise and services and to supply information they need to make informed decisions.

3. The President's commission recommends giving the new postal regulatory body after-the-fact review of rate changes made by the Postal Service. While it does call for a cap on rates, there will be concern expressed that this arrangement could allow the Postal Service to institute rate changes for monopoly products that could cause mailers significant financial damage. Do you think it would be appropriate to give the regulators a certain period of time to examine, and possibly alter, rate changes before they go into effect?

A carefully designed price cap mechanism balances the Postal Service's need for additional pricing flexibility with our customers' need for reasonable, predictable price changes. As a result, the price cap itself protects customers from significant financial damage. Prior regulatory review with a price cap mechanism would prevent the Postal Service from receiving the benefits of pricing flexibility.

4. The President's commission suggests that the new rate system they call for go into effect after the completion of one final rate case under the old rules. Since the outcome of this rate case will serve as the baseline for all future rate changes under the new system, how can we ensure that the process is not bogged down with the usual disagreements? What steps would Congress, the Postal Service and the regulators need to take to ensure that the case goes more smoothly than other rate cases have gone in the past?

We share your concern that the "baseline rate case" may serve as a last opportunity to air old disagreements which could divert focus from adjusting rates to meet the revenue requirement of the Postal Service. The central purpose of a baseline rate case is to align the revenue needs of the Postal Service to reflect the expected cost of providing postal products and services at the time postal reform legislation is implemented. A case which focuses on providing the appropriate revenue would not have all of the distractions of countless technical costing or rate and classification issues. This form of case would be more simple to litigate and allow everyone to more quickly move to the reformed postal ratemaking environment.

5. As you know, the President's commission recommends removing the statutory prohibition on closing post offices solely for economic reasons. Despite the fact that individual commissioners have stated that they do not want to see any post office closed if it is needed in order to provide universal service, there is some concern that their recommendation could lead to the closure of the small post offices that are often a community's identity and the only link access they have to retail postal services. In your view, does the Postal Service need to close individual post offices? Is it capable of doing so?

The Postal Service recognizes that post offices can contribute to community identity while constituting a critical means for providing universal service. These factors are examined closely whenever the Postal Service considers closing or consolidating any post office. America's need for post offices must, however, be balanced with today's economic reality which includes more tools for meeting customers' retail and delivery needs and for them to communicate with one another. Postage purchases via Internet, phone, the local grocery store, vending

machines, or the mail, and communications options involving the Internet, cellular phones and pagers all speak of an information age that had not begun when the existing network of post offices was created. The Postal Service is charged with providing fiscally prudent mail acceptance and delivery in a world that has changed enormously. Thus, it is economically sensible, reasonable and prudent to provide service through all available means, not just independent post offices. Some post offices warrant closing, but the viability of each must be evaluated using all available information, which includes community identity and alternative means of providing effective and regular service. Today, the retail network is adjusted to efficiently and effectively meet the needs of the American public; subject to existing constraints.

6. My bill and the President's commission both call on the Postal Service to begin finding ways to provide retail postal services in cheaper, more flexible ways. The Postal Service's own Transformation Plan described steps being taken to make this happen. What is the status of these efforts?

Enhancing retail access to our products and services is an ongoing effort. We offer stamp sales at over 16,000 ATMs, at consignment locations, online from usps.com and through the Stamps by Mail program. Contract postal units (CPUs) and other commercial agents and partners allow the Postal Service to reach customers at times when Post Offices are deemed inconvenient or are closed.

The introduction of postal retail services at approximately 1,200 Hallmark stores will be completed in 2004. Click-N-Ship, also introduced this year, allows customers to print Priority Mail labels from their own computers --- with or without postage --- is available on usps.com.

Our Self Service Platform— Automated Postal Center (SSP/APC) is a low-cost alternative to the retail counter that provides customers with convenient access 24 hours a day, seven days a week, to the postal products and services they most frequently need. Deployment of the SSP/APC is scheduled to start in 2004 and to be completed by December 2005.

Expanding access to postal services is an ongoing process. We are examining how technology and partnerships with other retailers can expand the use of self-service options and alternative points of access. Additionally, we are actively promoting existing access alternatives to increase customer awareness about what alternatives are available. Detail regarding status and next steps is contained in the recently released *Transformation Plan Progress Report* of November 2003.

7. In your view, can a vending machine, a small contract station or a post office located in a grocery store or pharmacy be an adequate replacement for a community's own post office?

These are all tools that can be used to help provide universal service and expand access. The Postal Service recognizes that some postal transactions, particularly those by bulk mailers and meter customers, must be conducted through a post office. However, many retail transactions do not require a customer to visit a post office. Generally, alternate retail access channels such as contract stations, post offices located in grocery stores or pharmacies, retail services provided by rural carriers, or Internet sales are effective and convenient means for providing retail services that present customers alternatives to a post office. It is important to keep in mind that these substitutes are not the only means of accessing retail services in communities where post offices are closed. The proximity of other retail facilities is considered in each post office closing case, and in many cases, post offices in neighboring communities are not too distant from a community where a post office is discontinued.

8. As you may know, the postal reform legislation I introduced this year would create a BRAC-like commission that would study the Postal Service's network of facilities and recommend that some be closed. The President's commission called for the creation of a similar body. In your view, how many of the Postal Service's existing processing centers can be responsibly closed? Are the facilities you believe can be closed located in certain parts of the country? Are there parts of the country that need new processing facilities? How much do you think the Postal Service would really save by closing processing facilities? Will a BRAC process be needed or can the Postal Service move forward on its own?

We appreciate the fact that the President's Commission highlighted the opportunities that exist in the area of network rationalization for the Postal Service to eliminate network redundancies and reduce high fixed infrastructure cost. The Postal Service's network has evolved over time in response to changing mail volumes, technology and customer needs. For the past several years, the Postal Services has been developing sophisticated modeling capabilities that enable us to evaluate the impact the demand effects of volume changes and population shifts to our mail processing and transportation network.

The Postal Service strategy is to design and build a new shape-based network that is more flexible and that allows us to scale network capacity up or down in response to changes in mail volume. Our approach is to deploy this new network strategy in select locations in the next couple of years, before initiating a large scale national implementation involving plant consolidations. We will not be able to provide further details until we receive results.

We believe that the expertise to make decisions on which facilities are necessary or not resides internally within the Postal Service. For us, network optimization is an ongoing activity which has been demonstrated by the fact that in the past two years we have consolidated excess capacity in our mail processing infrastructure

to the extent of 50 building annexes. The Postal Service believes it possesses significant internal expertise in the areas of mail processing and transportation to implement a new network strategy without the creation of a BRAC like process to study our network. The value of creating a separate Commission on this issue is questionable. It may help, but we need to see further details as to how it would approach the issue of network rationalization.

9. When studying whether a processing center should be closed, what factors should be considered? Should dollars and cents be the only factor?

The Postal Service has developed a data driven, scientific process using sophisticated modeling tools to analyze its mail processing and transportation network. The objective of this network modeling process is to create a flexible network that allows us to improve operational efficiency, reduce cost, and improve consistency of service for our customers.

The focus of the modeling effort is not to identify network facilities to be closed, but rather to identify the role and function a processing or transportation center plays in the future network. The models use a number of different criteria such as mail volume, service standards, operating costs, mail flows as well as physical characteristics of infrastructure in determining network optimization solutions.

10. Current law lays out a series of steps that the Postal Service must take before closing a post office. These are aimed in part at ensuring that the affected community is given notice and enough time to have their views heard. How much input do you think communities and employees should have during the plant closing process you call for in your report?

The role of a post office is different from that of a processing plant. A post office provides delivery and retail services in a specified geographic locality, and often serves as a source of community identity for a small community. By contrast, a plant is an automated processing facility that has responsibility for cancellation, distribution and dispatch of large volumes of mailpieces. The fact that a processing plant might be relocated or consolidated does not imply that retail or delivery services in a community served by the plant will be adversely affected. Moreover, a processing plant is not a source of community identity, as is the case with small local post offices in rural America. Thus, although community input in plant closings is encouraged and given due consideration, it must be appropriately balanced against the competing interest of promoting operational efficiency of the postal network.

As for input from postal employees, it should be noted that existing arrangements with organized labor already establish procedures for dealing with events such as plant closings or consolidations. When a business decision is made to close a plant, the national agreements between the Postal Service and its unions provide specific procedures and timelines for employee notification.

11. You have acknowledged in the past that some changes to the collective bargaining procedures used at the Postal Service may be necessary. It is my understanding, however, that all four postal unions have re-negotiated their contracts in recent years without going to arbitration. Those new contracts contained only modest pay increases. What, in your view, is wrong with the current procedures? How do the collective bargaining recommendations made by the President's commission address any problems you perceive?

As to the collective bargaining agreements currently covering each of the four major postal unions, the National Association of Letter Carriers, AFL-CIO, is under a negotiated agreement entered into in 2001. The American Postal Workers Union, AFL-CIO and National Postal Mail Handlers Union, AFL-CIO, agreed in 2002 to two-year extensions of their existing agreements. The previous agreement for the APWU had been an arbitrated one, while the previous agreement with the Mail Handlers had been reached through voluntary negotiations. The National Rural Letter Carriers' Association is operating under an arbitrated contract that went into effect in 2001.

As noted by the President's Commission, the current process for resolving post-impasse negotiations has been characterized by its protracted length and litigious nature. Even when the parties have come close to reaching agreement in negotiations, the current procedures can cause each side to "spring-back" to more extreme positions to protect themselves in the ensuing litigation.

The President's Commission recommends substituting fact-finding, which has been regularly waived by the parties, with a period of mediation conducted by the same individual who would ultimately serve as the interest neutral. A relatively short period of mediation seems better calculated than fact-finding to bringing the parties together, and it avoids the redundancy of multiple litigations.

Even though the statute might continue to leave the parties free to jointly devise their own procedures, it would still be valuable for the statute to provide a more suitable and effective dispute resolution process. An effective and efficient statutory process might find currency with the parties, or at least establish the context in which the parties would negotiate the process that they would jointly accept.

12. In your written testimony, you express opposition to a statutory limitation of the Postal Service's mission. The President's commission has proposed limiting that mission to accepting, collecting, sorting, transporting, and delivering the mail. You say that the Postal Service should be free to pursue "appropriate new revenue streams" in the future in order to protect universal service at a time of declining mail volume. It is my understanding that many non-postal products offered by the Postal Service in recent years, especially e-commerce products, have actually lost money. If this is the case, what new non-postal products do you think could help the Postal Service's bottom line? Is there some definition of the Postal Service's mission other than the one offered by the President's commission that you feel would offer you sufficient flexibility?

In defining the scope of the Postal Service's operations, the Postal Service should focus on its core mission of accepting, collecting, sorting, transporting and delivering the mail. As you know, future indicators suggest that the revenue stream from mail may not be enough to support our universal service obligation. Therefore, caution is needed to ensure that an overly-rigid scope of operations is not defined by legislation thus limiting appropriate use of assets that may generate revenue to partially offset future operating cost increases.

Today, and for many years, the Postal Service has offered services such as philatelic items that arguably might not be included in a very tightly-defined mission statement. In addition, limitations on nonpostal products should not restrict the licensing or leasing of postal assets as long as this does not negatively affect the core operations of the Postal Service. Initiatives facilitating the entry of mail or other uses of the mailstream should be permitted.

Post-Hearing Questions for the Record
Submitted to the Honorable John Potter, Postmaster General
From Senator Carl Levin

"The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability"

November 5, 2003

1. At the May 13, 2002, Government Affairs Committee hearing on the Postal Service's transformation plan, you said that, "We have begun a process of working with our union leadership to address some of our concerns about the collective bargaining process and the dispute resolution processes that we have." What progress have you made on those negotiations? You also said that you had discussed the proposed Med-Arb (mediation and arbitration) system with postal unions. What do you see as the possible points of agreement or tension between management and labor on that proposal?

We have met with the unions and had discussions regarding our concerns with the collective bargaining process and the possibility of exploring a Med-Arb process. While the discussions have not been concluded at this time, the unions have not shown an interest in modifying the collective bargaining model. We continue to work with the unions on improving our dispute resolutions processes and we have made progress. The number of grievances pending arbitration was reduced from 106,848 to 69,980 in FY 2003, a 34.5% reduction.

2. Today, people can purchase stamps at some ATM locations, grocery stores, and over the Internet. In addition, the Postal Service has developed self-service kiosks that provide many postal products and services. The Presidential Commission's report has proposed expanding services provided at locations other than post offices. What are your thoughts on this proposal?

Expansion of our products and services to locations other than post offices is critical to meet the needs of our customers, particularly in our high growth areas. Today, we have over 20,000 consignment locations in businesses selling stamps and over 16,000 ATMs at banks that sell stamps, as well as a network of Contract Postal Units (CPUs) that sell postal products and services. Alternative channels to sell our products and services have been and will continue to be a major element of our retail network. We have recently awarded a contract to a vendor to provide 2,500 self service kiosks that perform 80% of the most common transactions conducted at our counters. These will be deployed beginning in the spring of 2004.

3. I understand that currently about 80 percent of stamps are sold at post offices and a Postal Service survey shows that 1 in 3 people go to post offices solely to buy stamps. If the Commission's proposal to expand services provided at locations other than post offices were adopted, how would you see the future of local post offices?

Post offices are an important element of our retail network and will continue to be. If more customers rely on alternative channels for simple transactions such as stamp purchases, however, then our retail sales associates will be able to focus on customers needing assistance in completing more complex transactions. In lieu of selling stamps, postal retail outlets can and should focus on complex transactions and mailing solutions, such as those involving parcels, international mail requirements, special services, and money transfers.

4. It is my understanding that some 47 percent of USPS career employees will become eligible for regular retirement by 2010. How does the natural attrition of the postal workforce match-up with your view of the labor demands of a future postal service?

The Postal Service has committed to reduce the expenses of our operating base and to accomplish this, we have begun to implement a number of initiatives to improve operational efficiencies. These include efforts to automate mail forwarding operations, further automate the processing of large envelopes, magazines and packages, and to reduce transportation costs by maximizing our distribution/transportation network. These automation measures in addition to future operational efficiencies require the Postal Service to review and adjust our complement requirements as we move forward. We have determined that we have surplus positions and in addition to natural attrition we are using Voluntary Early Retirement as a tool in our downsizing strategies.

Post-Hearing Questions for the Record
Submitted to the Honorable John Potter, Postmaster General
From Senator Daniel Akaka

"The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability"

November 5, 2003

1. If the Postal Service is successful in shifting the military service payments back to the Treasury, will the savings gained by such a shift keep down future rate increases and find retiree health benefits? Would moving military retirement payments back to Treasury affect the used for postal reform?

P. L. 108-18 retroactively imposed upon postal ratepayers the assessment of the costs of military service that rightly have always been borne by taxpayers, who are the beneficiaries of that service. In its July 31, 2003 report to the President, the President's Commission on the United States Postal Service recommended that "taxpayers, not ratepayers, should finance costs associated with military service." The Postal Service itself proposed to the President, the Congress and the General Accounting Office that the military payments requirements of P. L. 108-18 that transferred $27 billion in costs to the Postal Service ($17 billion for the period 1971 – 2002 and $10 billion for 2003 and beyond) be amended, and that the obligation for these payments be returned to the United States Treasury. Without the cost of military service payments, at the end of 2002, the Postal Service had already over funded its obligations to the Civil Service Retirement and Disability Fund (CSRDF) by $10 billion.

Further, in accordance with the recommendation of the President's Commission that, when financially able to do so, the Postal Service should pre-fund retiree health care benefits. As reported by the Postal Service in the MD&A section of its 2003 annual report, as of September 30, 2003, the present value of the Postal Service obligation for retiree health benefits was between $47 billion and $57 billion. The $27 billion in retirement funds, now allocated to cover military service, already has been collected from ratepayers while the health benefits obligation has been growing. The Postal Service proposal, filed in its September 30, 2003 recommendation to Congress, is to allocate these funds toward the health benefits obligation and begin to fund future costs.

The Postal Service proposed that these funds remain in the CSRDF and be designated as the Postal Service Retiree Health Benefit Fund. With this change, this fund would increase to $18 billion in 2006 ($10 billion CSRS over-funding at the end of FY 2002 plus $5.5 billion in retirement payments for current CSRS employees in FY 2003, 2004 and 2005 plus interest of $2.4 billion). That being the case, starting in 2006, the Postal Service would utilize the "savings" (the difference between pre- and post P. L. 108-18 CSRS contributions by the Postal Service) realized through the Act to pre-fund retiree health benefits on a current basis.

This, in and of itself, would lessen the pressure on the size of future rate increases. However, in order to pre-fund retiree health benefits as recommended by Congress in P. L. 108-18, additional funding, over and above funds made available by the return of the payments made for military service and the "savings" realized under the Act, would be necessary. These would come from a moderate, perhaps phased-in, increase in rates.

The Postal Service believes this proposal is in the best interest of the American taxpayer and the postal ratepayer. It will help stabilize postal rates, use funds already paid by the Postal Service for the general purpose for which they were intended and collected from postal ratepayers, maintain these funds in the CSRDF for the benefit of all postal CSRS and FERS employees and retirees, reduce long term Postal Service obligations, and addresses the concerns surfaced by the GAO and reflected in the Sense of Congress statements enacted in P. L. 108-18. This proposal further moderates the risk that the Treasury would be left responsible for, should the business model of the Postal Service not remain viable.

Transferring military service payments back to Treasury would not lessen the need for postal reform. Continuing decline in First-Class Mail volume, growth in the delivery network, an outdated ratemaking process, and continuing marketplace changes threaten the long-term ability of the Postal Service to provide universal service. Thus, the need for postal reform would remain even after these recommended actions.

2. The Presidential Postal Commission recommends requiring the use of a 30-day mandatory mediation process followed by arbitration if mediation fails. Aside from this time limitation, my understanding of title 39 is that the Postal Service already has the flexibility to use mediation/arbitration, last best final offer, and other collective bargaining options. Would you share with us whether you support moving to a mandatory process, and what might exist to implement this process?

The current provisions of Title 39 do permit the parties to establish their own dispute resolution process, which with agreement of the parties could contain the features mentioned above. Absent agreement, the statutory process, with an initial fact-finding procedure followed by interest arbitration, must be used. Fact-finding, in fact, has been regularly waived by the parties. This would seem to demonstrate that the statutory process is not serving the parties' interests. The President's Commission recommends substituting fact-finding with a period of mediation conducted by the same individual who would ultimately serve as the interest neutral. A relatively short period of mediation seems better calculated than fact-finding to bringing the parties together, and it avoids the redundancy of multiple litigations. Even though the statute might continue to leave the parties free to jointly devise their own procedures, it would still be valuable for the statute to provide a more suitable and effective dispute resolution process. An effective and efficient statutory process might find currency with the parties, or at least establish the context in which the parties would discuss the process that they would jointly accept.

3. The Postal Service recently reported that it has reduced its career workforce over the past five years by about 67,000 employees. Do you expect this trend to continue, and if so, what would you expect the workforce size to be in five years?

It is expected that the size of the postal workforce will continue to decline over the next five years. The business climate, market conditions, and automation programs are factors that can significantly affect the extent of this trend.

4. The Postal Service recently announced a voluntary retirement program for some of its union-represented employees. How many employees are expected to leave under this program, and do you think this is a successful mechanism to restructure the postal workforce?

The first group of union-represented employees to be offered Voluntary Early Retirement (VER) was the American Postal Workers Union (APWU). Approximately, 3,600 APWU employees accepted the offer as of December 2003, with the next wave of acceptance expected by the end of January 2004.

In light of the number of positions that we need to eliminate from the Postal Service as we continue to improve operational efficiencies and respond to external business drivers, VER is an effective tool in our downsizing strategies

5. Many constituents have raised concerns over the Postal Service's plans to close post offices. What are the plans relating to post office closings, and what criteria will the Postal Service use to determine whether a post office will close or remain open?

The Postal Service currently reviews operations of a post office when there is a postmaster vacancy, or some unforeseen event such as a fire, flood or eviction from a leased facility. Post office discontinuance actions are subject to the closing procedures of 39 USC 404(b), which requires detailed consideration of the effect of a closing on postal services, the community, employees and economic savings

6. The Commission recommended that Congress clarify in statute the Postal Service's mission and role by defining universal postal service, including the activities of the Postal Service. Do you agree that it is Congress' role to make a legislative definition of universal service and outline the Postal Service's mission and role?

Yes. Fundamental universal service expectations should continue to be set by Congress in the law, in the format of broad mission statements that allow for administrative flexibility as conditions change. Sections 101 and 403 of current law require the Postal Service to bind the nation together through a national mail service providing reasonable access for all communities while delivering a full-service product line for letters, publications, and parcels. The statute contemplates that the Postal Service will strike a balance among service, revenue, and operational concerns. We believe this has been a successful approach for the last three decades and should be continued.

7. The Commission also recommended significant changes in the authority of the independent postal regulator versus the role of the proposed Postal Service's Board of Directors. What do you think should be the guiding principles in establishing the appropriate balance between the authority and responsibilities of the regulator and the Directors?

While it is difficult to draw a bright line test as to the division of responsibilities between a regulator and an operator, the Postal Service submits that authority over certain fundamental national policy matters, as well as authority that could impair or significantly alter day-to-day management of the Postal Service, are outside the purview of a regulator. Rather, these matters should be managerial responsibilities within the oversight of the Governors or Directors, or public policy functions reserved to the nation's lawmakers.

In other words, the Postal Service recognizes the wisdom of current law, which leaves public policy decisions to the Congress, gives management and operational authority to the Postal Service, and establishes a regulator as a review mechanism.

For example, public policy issues such as universal service, the scope of the monopoly, and access to the mailbox define what the nation as a collective whole expects from its Postal Service. Congress, which is ultimately accountable to the public, needs to address such questions.

8. The Commission stated that the Postal Service should set the standard for financial transparency by which all other federal entities are judged and recommended that the Postal Service voluntarily comply with applicable provision of the major SEC reporting requirements? Do you agree, why or why not?

Regarding financial transparency, the Postal Service has been cited as a model for other federal entities to emulate in financial reporting. Donald V. Hammond, Fiscal Assistant Secretary of the U. S. Treasury, who is responsible for the development of the government-wide financial statement, stated in his testimony before the House Government Reform Subcommittee on Government Efficiency on April 8, 2003:

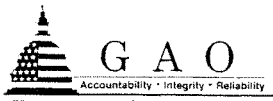
> **"This is the sixth year we have prepared consolidated, government-wide financial reports. There have been significant improvements in the agency data. This year, 21 of the 24 CFO Act agencies received clean audit opinions, up from 18 last year and just 6 agencies only 7 years ago. Also, three major agencies, the Social Security Administration, Treasury Department and U.S. Postal Service, completed their financial statement audits by November 15, which was three and a half months earlier than statutorily required. This is a significant achievement and is a model for all agencies to improve the timeliness and usefulness of their financial data. In addition to these improvements in timeliness and data quality, the report includes the summary schedule of total government commitments that improves the transparency of the data."**

The Postal Service has been judged to excel in its financial reporting not only in relation to that of other government entities but also in relation to the reporting of publicly traded companies and private non-profit organizations. In the last three years alone, the Postal Service has won the following national competitive awards for financial reporting:

- 2000 Financial Statements - 2000 International Arc Awards: Grand Winner - Best of Financial Data
- 2000 Financial Statements - 2001 American Business Communicators: First Place - Narrative Presentation
- 2001 Financial Statements - 2002 International Arc Awards: Gold Winner - Business Writing
- 2001 Financial Statements - 2003 American Business Awards: *Stevie* Finalist - Best Annual Report.

The Postal Service, while honored by these assessments of the quality and depth of its financial reporting, is committed to doing even more. Management recommended, and the Board's Audit and Finance Committee concurred, that the Postal Service voluntarily take action to further enhance its financial transparency in line with the intent of the President's Commission's recommendations.
Our focus is to continue to transition our financial reporting, taking actions which enhance understanding of the financial condition of a non-publicly traded, non-stockholder owned company. Currently, we post monthly financial and operating reports on the Postal Service web site as well as quarterly financial reports that include discussion and analysis of operating results and future expectations. We also post quarterly reports on revenue and volume by product. On an annual basis, we publicly disclose and publish audited financial results, an Annual Report, a Comprehensive Statement to Congress, as well as a Cost and Revenue Analysis Report that provides product cost allocation and margins. Many observers have stated that the extent of these data exceeds that provided by companies filing SEC reports.

As the Postal Service proceeds with the transition to increased reporting, it will include an expanded Management Discussion & Analysis section in the quarterly reports in FY 2004. The Postal Service has added to its FY 2003 annual report the following sections that are consistent with SEC reporting requirements: description of the business, description of legal proceedings, description of Board of Governor activities, expanded disclosures in capital and financing, description of the ethical conduct standards, and discussion of principal accountant fees and services. In addition, it has recently added a section on its web site to report SEC Form 8-K type information on significant financial transactions and business transactions.



Comptroller General
of the United States

United States General Accounting Office
Washington, DC 20548

December 12, 2003

The Honorable Susan M. Collins
Chairman, Committee on
Governmental Affairs
United States Senate

Dear Chairman Collins:

This letter responds to your request for additional information related to the Committee's November 5, 2003, hearing titled "The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability." Enclosed are our responses to questions that Senators Carper and Akaka asked in your letter dated November 24, 2003. Our responses are based largely on information contained in our published reports and testimonies related to the Postal Service and other organizations and reflect our views based on that information.

If you have any further questions or would like to discuss these responses, please call Bernard L. Ungar, Director, Physical Infrastructure Issues, on (202) 512-2834, or Teresa L. Anderson, Assistant Director, Physical Infrastructure Issues, on (202) 512-7658.

Sincerely yours,

David M. Walker
Comptroller General
of the United States

Enclosure

cc: Senator Daniel K. Akaka
Senator Thomas R. Carper

Enclosure

Questions for the Record: 11/5/03 Hearing by Senate Committee on Governmental Affairs

Questions from Senator Tom Carper

1. *The President's commission recommends giving the new postal regulatory body after-the-fact review of rate changes made by the Postal Service. While it does call for a cap on rates, there will be concern expressed that this arrangement could allow the Postal Service to institute rate changes for monopoly products that could cause mailers significant financial damage. Do you think it would be appropriate to give the regulators a certain period of time to examine, and possibly alter, rate changes before they go into effect?*

In our view, regulatory review of rate changes, classifications, and costing methodologies should vary depending on the type of postal product and service and the potential for rate changes to create financial risk for the mailing industry, U.S. Postal Service (the Service) competitors, and other postal customers, including the American people. In this regard, we believe it would be useful to focus on changes applicable to five key areas: (1) existing market-dominant postal products, including those covered by the postal monopoly; (2) existing competitive postal products; (3) new postal products, including those being offered as market tests or on an experimental basis; (4) negotiated service agreements (NSA) that establish customer-specific postal rates; and (5) general reclassification of the entire rate structure that can greatly change mail categories and the postal rates applicable to these categories. Our response will highlight some key considerations applicable to each of these areas.

First, with respect to market-dominant postal products, a price cap system could limit rate increases for these products according to a specified index, such as the Consumer Price Index. If rates for market-dominant products increased at regular intervals by small and predictable amounts that were within the price cap, that would lessen the potential for financial risk and thus lessen the need for prior review. Conversely, if the price cap system allowed for a large general rate increase to cover "exigent" circumstances, that increase should merit close scrutiny, particularly because it could have adverse effects on mailers, customers, and the national economy. Prior review of rate increases exceeding the price cap would appear to be appropriate because such increases would violate the intent of a price cap, which is to create pressure for the Service to operate efficiently and economically, as well as to protect captive customers from unwarranted rate increases.

Second, with respect to competitive postal products, a key issue will be whether these products should be required, individually or collectively, to cover their attributable costs and make a specified minimum level of contribution to cover the Service's institutional costs. In the absence of such a requirement—such as meeting the bare minimum of not being cross-subsidized (i.e., covering all incremental costs)—the Service could shift institutional costs from competitive to market-dominant products, which could create financial issues for mailers, the Service's competitors, and customers. In this regard, if the Service's prices for its competitive products are to be largely deregulated, while the Service retains its statutory monopoly, then Congress will need to assure that a mechanism is in place to deal with issues of fair competition.

Enclosure

Third, if experimental postal products were to be introduced via market tests, some prior review could be appropriate, depending on the duration or size of the market test, the pricing (e.g., whether revenues would be expected to cover costs), and whether the test was applicable to competitive or market-dominant products. Prior review also could consider what data collection would be appropriate, particularly with respect to costs, revenues, and volumes.

Fourth, with respect to NSAs, we believe that prior review would make sense for the foreseeable future, particularly because the Service has reported that it generally does not have mailer-specific cost and revenue data to support proposed NSAs that would grant mailer-specific rate discounts. This situation creates a real risk of competitive harm; it also violates the long-standing principle that a federal establishment such as the Postal Service should not make undue or unreasonable discrimination among users of the mails or grant undue or unreasonable preferences to any such user. However, among NSAs, criteria for review could differ depending on whether the rate change applies to a new or existing NSA, whether the NSA applies to a competitive or market-dominant product, and whether the regulatory agency, given the input of interested parties, believes that prior review would be appropriate.

Fifth, we believe that general reclassification of the entire rate structure should receive prior review, because such broad changes would likely result in large changes to postal rates applicable to some mailers. For example, the 1995 reclassification proposed by the Service would have created substantial shifts in the responsibility for paying the large institutional costs of the Service, which were then about $20 billion annually. Individuals, small businesses, and publishers of small newspapers and small circulation magazines would have paid more, while large business mailers, large circulation publishers, and saturation mail advertisers would have paid less. The prior review of this reclassification resulted in the Postal Rate Commission (PRC) recommending much of what the Service proposed in order to link postal rates more closely with costs. The PRC also rejected some changes in consideration of the mandate for the Service to be operated as a basic and fundamental service provided to the people, among other reasons. In this regard, it would be appropriate for Congress to consider what statutory criteria should guide regulatory consideration of any rate and classification changes that continue to receive prior review.

Finally, an overarching consideration relating to any after-the-fact review is the degree to which reliable data on postal costs can be provided in a timely manner. Much of the time required for the 2000 rate case—the last fully litigated omnibus rate case—was focused on efforts to obtain more recent and accurate cost information, as well as consider complex methodological issues relating to data quality. For after-the-fact review of postal rates to be successfully implemented with prompt review for compliance and rapid disposition of complaints, it would be important for timely and reliable cost information to be readily available. Recognizing this need, the President's Commission on the United States Postal Service (the Commission) recommended that the newly created Postal Regulatory Board have broad new authority over the level of detail needed to satisfy rigorous new financial reporting requirements, including the authority to request accurate and complete information from the Postal Service and the use of subpoena powers if necessary. We believe that the need for timely and reliable cost information should be viewed as an essential part of any package that provides the Service with the flexibility to change postal rates without prior review.

Enclosure

2. *The President's commission suggests that the new rate system they call for go into effect after the completion of one final rate case under the old rules. Since the outcome of this rate case will serve as the baseline for all future rate changes under the new system, how can we ensure that the process is not bogged down with the usual disagreements? What steps would Congress, the Postal Service and the regulators need to take to ensure that the case goes more smoothly than other rate cases have gone in the past?*

Your concern that a baseline rate case could be beset by perennial disagreements is well founded, but steps could be taken to resolve some key disagreements that otherwise would likely arise in a baseline case. As we testified, cost allocation issues have been debated for many years and are frequently a key reason why postal rate cases are so lengthy and litigious, since their disposition can directly affect postal rates. Under current law, all parties can raise whatever issues they wish, regardless of how many times the same issues have been considered in the past. Given the importance of a baseline case, the parties can be expected to use their discretion to raise many unresolved issues and litigate them to the fullest possible extent. This outcome would likely lead to a baseline case that would be much more litigious and proceed less smoothly than a typical rate case. Indeed, the PRC recently reported that a baseline case would likely be "the most complex and contentious case ever heard by this body." The PRC concluded that "participants could be expected to challenge every cost allocation and raise every policy consideration" that would affect rate levels, adding that "All types of mailers would be likely to consider it in their best interests to actively participate." To put these statements into context, the Postal Service has reported that just its initial filing for the 2000 rate case generated more than 100,000 pieces of paper and that 177 witnesses representing 76 parties submitted testimony during more than 41 days of hearings held for this proceeding. We are concerned that it will be difficult for the PRC to carefully consider all of the material related to a case that would be more complex than usual and complete it within the current 10-month statutory deadline.

Several options could be considered to help smooth the transition from the current rate-setting structure to a new system and enable the PRC to handle the many issues that could be involved in a baseline case. One option could be for Congress to urge the parties to use their discretion to negotiate settlements to technical issues of cost allocation before a baseline case begins and formally agree not to exercise their rights under the old rules to relitigate the same issues in a baseline case. A second option could be for Congress to mandate a separate proceeding to resolve key technical issues and/or procedural rules before a baseline case begins and require that the outcome be binding for the purposes of the baseline case. This option may prove necessary to ensure that a baseline case is not bogged down in considering perennial issues, given the practical difficulties of obtaining voluntary agreement on contentious issues among many diverse stakeholders. Another option could be to grant the PRC additional authority to compel the provision of necessary information for the baseline case. Finally, if all issues were to be deferred to the baseline case, Congress could consider extending the statutory deadline for this case.

On the positive side, some progress is possible under the current structure. Recently the Postal Service and the PRC sponsored joint public sessions to discuss changes made in the Service's financial and accounting systems. These sessions were well attended and offered opportunities for the Service to explain the nature and purpose of the changes and for interested stakeholders to ask questions. This type of forum could be useful in addressing other technical issues that could relate to a baseline rate case.

Enclosure

In addition, some issues may be better addressed in other formal PRC proceedings before a baseline case begins. For example, the methodology for allocating mail processing costs is the type of technical issue that could and should be resolved before the inception of a baseline case. The Service's long-running disagreement with the PRC over how to allocate mail processing costs has already generated thousands of pages of evidence and many arcane technical disputes. Resolution of this issue would be especially helpful for a baseline case, since it would eliminate the need for the Service to file two sets of documents according to the Service's and the PRC's preferred methodology for allocating mail processing costs that would then be considered by the involved parties. We are optimistic that the parties can make progress in this specific area if they have the will to resolve their differences.

We also note that resolution of some technical issues may require the Service to make improvements to its cost allocation methods and underlying data systems that collect information for ratemaking purposes. Therefore, this issue of whether a transition period would be needed should be carefully considered in conjunction with options to enable the parties to address long-standing disagreements before a baseline case begins.

3. *As you know, the President's commission recommends removing the statutory prohibition on closing post offices solely for economic reasons. Despite the fact that individual commissioners have stated that they do not want to see any post office closed if it is needed in order to provide universal service, there is some concern that their recommendation could lead to the closure of the small post offices that are often a community's identity and the only link access they have to retail postal services. In your view, does the Postal Service need to close individual post offices? Is it capable of doing so?*

Yes; we agree with the Commission that the Postal Service also needs to constructively address the fact that many of the nation's post offices are no longer necessary to the fulfillment of its universal service obligation, given the proliferation of alternate retail access points in grocery stores, drug stores, automated teller machines (ATMs), and other more convenient locales across the country. Also, as we noted in our January 2003 report that put federal real property on our High-Risk List, the issue of excess and underutilized property will need to be part of the Service's efforts to operate more efficiently.[1] Facility consolidations and closures are likely to be needed to align the Service's portfolio with its changing business model. However, to date, the Postal Service has not provided information on the number and location of post offices no longer needed to provide universal postal services. Therefore, as we have testified, the Service needs to engage with its stakeholders in developing a publicly available comprehensive plan for rationalizing its retail and mail processing infrastructure.

In developing this plan, we believe that the Service needs to review its entire network of post offices, branches, and stations and close those that are not needed to provide universal postal services. At the same time, closing individual post offices does not necessarily mean that the number of locations where retail postal services are available will or should be reduced. There are significant opportunities to provide access to retail postal services in other retail establishments. However, given the importance of the post office network to providing

[1] U.S. General Accounting Office, *High-Risk Series: Federal Real Property*, GAO-03-122 (Washington D.C.: Jan. 2003).

Enclosure

universally available postal retail service, it is critical that the Service lay out its comprehensive plan for its retail infrastructure, including standards, criteria, and strategies for providing universally accessible retail services. We believe that the Service should strive to improve accessibility, quality, and the cost effectiveness of postal retail services as it implements its strategy of rationalizing its retail network, including determining whether brick-and-mortar post offices are needed versus other alternatives. That is why we concurred with Commission recommendations that the Service should (1) dramatically escalate its efforts to increase alternative access to postal services and (2) market these alternatives more aggressively. Further, we stated that the Postal Service must assure Congress that its strategy of retail realignment will be implemented in a fair, rational, and fact-based manner. It is also incumbent on the Service to engage with affected stakeholders to address legitimate concerns, minimize disruption, and seize opportunities to improve the quality and accessibility of postal retail service. The Service's Transformation Plan Progress Report, which was issued after the hearing before your committee, provided a general overview of how the Service intends to "Optimize the Retail Network." This material provided little information on which to base an opinion regarding the need to close individual post offices.

As you know, the Service's ability to close individual post offices has been limited by restrictions set forth in annual appropriations legislation. As a practical matter, the Service has faced strong opposition to post office closings from local communities, affected members of Congress, and others opposed to closing post offices. Further, in recent years the Service has been limited by financial constraints, including the need to reduce its debt, that have required the Service to finance capital investment exclusively from operating surpluses. Moreover, it is difficult to say what financial constraints might limit the Service's future ability to realign its retail infrastructure, in part because the Service has provided little information on the costs involved and how those costs would be financed.

4. *My bill and the President's commission both call on the Postal Service to begin finding ways to provide retail postal services in cheaper, more flexible ways. The Postal Service's own Transformation Plan described steps being taken to make this happen. What is the status of these efforts?*

According to the Service's Transformation Plan Progress Report, each of the Service's four transformation initiatives to expand access to postal retail services is "in process." These initiatives include efforts to move simple transactions out of post offices; create new, low-cost retail alternatives; optimize the retail network; and develop new retail services that increase customer value and Postal Service revenue. The following briefly summarizes the status of these efforts.

- In November 2002, the Service launched a national campaign promoting alternative access to postal products and services to create customer awareness of stamp-purchasing alternatives. This campaign included television and print ads, in addition to new logos and postal product signs that are displayed at 60,000 locations that sell stamps, including over 16,000 ATMs.

- In March 2003, the Service approved deployment of a self-service retail kiosk that will enable customers to weigh letters, flat-shaped mail (such as large envelopes), and parcels; as

Enclosure

well as to purchase postage. Initial deployment for field evaluation is scheduled for the middle of fiscal year 2004 and full deployment is planned by the end of December 2005. In addition, the Service is partnering with commercial retail outlets to sell postal products. The Service signed an agreement with Hallmark in September 2002 for the use of postage meters, and postal retail services are to be offered by about 1,200 Hallmark Gold Crown stores by the end of fiscal year 2004.

- The Service is developing a Retail Network Optimization initiative to maximize retail access, provide equal or better value for the Service's customers, and avoid unnecessary future postal expenditures. Field training for closing post offices was completed in August 2002, and Phase One for closing 230 currently suspended post offices was finalized in November 2002. Phase Two, involving the closure of 281 currently suspended post offices, is to be finalized by the middle of fiscal year 2004. However, as noted in the answer to the previous question, the Service has provided little additional information on the status of its Retail Network Optimization Initiative.

- The Service is developing "new services that will be offered at some postal retail locations" as well as "expanding and enhancing services it already provides for government and commercial partners, such as acceptance of passport applications." No specifics were provided regarding which new services are under consideration, when they might be introduced, or what the Service's goals are for raising new revenues in this area.

5. *In your view, can a vending machine, a small contract station or a post office located in a grocery store or pharmacy be an adequate replacement for a community's own post office?*

Yes; however, to ensure that the community continues to have ready access to quality postal retail services, the Service's decisions on post office closings need to be made by applying certain key principles and concepts to the facts and circumstances applicable to each post office and local community. As your question recognizes, the specific manner in which retail service is provided is critical to addressing the question of whether retail alternatives can adequately replace a traditional brick-and-mortar post office that is located in a dedicated postal facility. Contract postal units and other commercial agents and partners may provide customers access to postal retail services when post offices are normally closed. Typical locations for these units are shopping centers and local malls, and the Service is also targeting grocery store chains and convenience stores. The suitability of other retail alternatives would depend on their quality and accessibility, the scope of the services, and the communities' needs.

6. *As you may know, the postal reform legislation I introduced this year would create a BRAC-like commission that would study the Postal Service's network of facilities and recommend that some be closed. The President's commission called for the creation of a similar body. In your view, how many of the Postal Service's existing processing centers can be responsibly closed? Are the facilities you believe can be closed located in certain parts of the country? Are there parts of the country that would need new processing facilities? How much do you think the Postal Service would really save by closing processing facilities? Will a BRAC process be needed or can the Postal Service move forward on its own?*

Enclosure

We agree with the Commission that the Service has many opportunities to become more efficient, notably by standardizing its operations and reducing excess capacity in its mail processing system. Further, Service data indicate wide variations in efficiency among mail processing facilities. However, we do not have adequate information at this time to express an informed view as to how many mail processing facilities need to be closed or opened, or where such closures or openings should take place. As we testified, to date, the Service has not made public a comprehensive infrastructure rationalization plan. We continue to have concerns about the lack of publicly available information on the Service's plans and related funding strategies in this area. In the absence of such information, it is difficult to assess the needs for change in the Service's mail processing network. This gap led to the recommendation we made in our November 5, 2003 testimony that the Service provide Congress with such a plan.

This information gap was addressed by the November 19, 2003, letter sent to the Postmaster General from Chairman Collins and yourself, which requested that he provide the Senate Committee on Governmental Affairs with a plan by April 7, 2004, that lays out how the Postal Service intends to optimize its infrastructure and workforce, including its vision in this area and how it plans to reach it. We agree that the plan should describe the criteria, process, and data the Service will use to make decisions, and address the strategies, timing, and funding necessary to implement these plans. We also agree that the plan should describe the parties consulted in its development, and we are hopeful that the Service's communication and coordination with postal stakeholders will provide an opportunity for the Service to discuss how it plans to rationalize its mail processing network with the Governmental Affairs Committee in greater detail.

Postal Service consultations with stakeholders should give them a better understanding of the Service's vision and plans and address stakeholders' legitimate concerns, thereby helping to alleviate much of the resistance that the Service has historically encountered from employees, mailers, communities, and Congress when it attempted to close facilities. Anticipating such resistance, the Commission recommended that a Postal Network Optimization Commission (P-NOC), modeled in part after the Defense Base Closure and Realignment Commission, be created to make recommendations relating to the consolidation and rationalization of the Service's mail processing and distribution infrastructure. These recommendations are to be submitted to the President, and once approved, to the Congress. Under the Commission's proposal, P-NOC recommendations would become final unless Congress disapproves them in their entirety within 45 days. A base-closing model may prove a necessary process to address politically sensitive changes to postal facilities; or alternatively, some other process may be feasible that gives stakeholders including Congress an opportunity to review and approve the Service's plans for its mail processing and distribution infrastructure. As you consider what process might be appropriate, a key factor will be whether the Service approaches this area in an insular, incremental fashion, or uses the opportunity presented by your letter to divulge its network rationalization plans and engage with stakeholders who may be affected.

7. *When studying whether a processing center should be closed, what factors should be considered? Should dollars and cents be the only factor?*

Two key factors to consider when reviewing the possible closure of a mail processing facility, include (1) the Postal Service's need for the facility so the Service can continue to provide high-

Enclosure

quality, secure postal delivery service, including mail transit times in accordance with Service standards and (2) financial efficiency, including the financial savings that may accrue in the short term and long term. However, individual facility decisions are best made in the context of a comprehensive, integrated plan for the Service's mail processing and distribution infrastructure because each facility is part of an integrated network, and the disposition of one facility can have important effects on others. In this context, the Service's total available resources for mail processing and distribution should be considered, as well as the Service's vision and plans for standardizing and modernizing its facilities and providing adequate security in view of the anthrax attacks during the fall of 2001. Further, it will be important to implement change in this area in a manner that considers the impact on postal employees, customers, and affected communities.

8. *Current law lays out a series of steps that the Postal Service must take before closing a post office. These are aimed in part at ensuring that the affected community is given notice and enough time to have their views heard. How much input do you think communities and employees should have during the plant closing process you call for in your report?*

We believe an important principle is for those who are affected by facility closures, including affected communities and employees, to have meaningful input into the decision-making process. This input should be structured in conjunction with two other key factors to guide decisions: principles for rationalizing infrastructure that are fact-based, clearly defined, and transparent, and processes that should govern how decisions are made and implemented. In addition, as noted above, it will be important for such input to be offered and considered in the context of a comprehensive, integrated plan for rationalizing the Service's infrastructure and workforce.

9. *You have acknowledged in the past that some changes to the collective bargaining procedures used at the Postal Service may be necessary. It is my understanding, however, that all four postal unions have renegotiated their contracts in recent years without going to arbitration. Those new contracts contained only modest pay increases. What, in your view, is wrong with the current procedures? How do the collective bargaining recommendations made by the President's commission address any problems you perceive?*

Although it is laudable that the Service and major postal labor unions have negotiated recent contracts without going to binding arbitration, this has not always been the case. As the Commission concluded, the current collective bargaining system provides few incentives for the parties to reach a negotiated settlement, resulting in lengthy proceedings that foster management-employee discord and deter timely and reasonable compromises. Commission recommendations addressed these deficiencies by calling for a "mediation and arbitration" model to ensure that each stage of the labor-management dialogue builds on progress made in previous negotiations, accompanied by revised time frames that are intended to produce more rapid resolution.

Commission recommendations also addressed issues of workplace costs, flexibility, and comparability, such as the recommendations to expand the scope of the collective bargaining process to cover all individual components of compensation, including retirement and health care benefits, and to subject the collective bargaining process to binding regulatory decisions that

Enclosure

interpret pay comparability. Our November 5, 2003, testimony before your Committee discusses our concerns regarding these recommendations but also noted that the Commission's recommendations in the human capital area deserve close scrutiny and a fair hearing. As we testified, a package of changes may ultimately be made that is mutually beneficial to the Service, its employees, and the public.

In addition, the Commission's recommendations to improve the collective bargaining process may help to focus attention on developing a pay-for-performance compensation program that provides meaningful incentives for all postal employees to personally advance the productivity, cost efficiency, and service quality goals of the Postal Service. The Commission's recommendations are intended to minimize prolonged, adversarial contract disputes and to enable the Service to repair its strained relationship with its employees and labor unions. Better labor-management relations will help enable the Service and union leadership to work together and reconsider difficult issues where progress will be important to the Service's success. In this context, progress may be possible in addressing results-oriented pay reform that more closely links individual performance to organizational goals.

Questions from Senator Daniel Akaka

1. *You and I share the belief that there needs to be greater financial transparency within the Postal Service. The Commission found that financial reporting has not provided a clear picture of the Postal Service's fiscal condition. A good example is the period from November 2000 through February 2001 when the estimated operating loss for FY 2001 jumped from $480 million to over $2 billion. To address the need for greater financial transparency, the Commission recommends that the Postal Service voluntarily comply with the Securities and Exchange Commission's reporting standards. Do you believe the reporting requirements should be voluntary or mandatory, and what incentive would there be for the Postal Service to comply voluntarily?*

As we testified, the Commission enunciated an ambitious standard for the Service when it stated that "As a unifying force in American commerce and society, and as a customer-financed government endeavor, the Postal Service should be setting the standard for financial transparency by which all other Federal entities are judged." [Emphasis in original.] The Commission also found that given its important public mission and central role in the nation's economy, changes in the Service's economic health should not come as a surprise to those responsible for or impacted by its performance. In this regard, the Commission found that while the Service often conducts financial reporting over and above what is required by federal agencies, it remains behind the level of disclosure offered by its corporate peers.

We believe that financial transparency is an important matter, and the Service should lead by example in the area of financial reporting and disclosure. Thus, technical compliance with accounting and reporting requirements should be a floor for financial transparency, not a ceiling. We were pleased that the President's Commission strongly recommended that the Postal Service voluntarily comply with applicable provisions of the major Securities and Exchange Commission (SEC) reporting requirements. We were also pleased that the Postmaster General stated in his November 5, 2003, testimony that the Service will continue to transition its financial reporting along the lines of SEC requirements, where those requirements make sense when applied to a

nonpublicly traded, nonstockholder owned company. It will be important for Congress to obtain clarification from the Service on how and when it intends to develop financial statements and disclosures comparable to those provided by publicly-traded companies. If Congress determines that the Service's proposed approach is not acceptable or timely, or if the Service does not fulfill the commitment it makes in this regard, Congress could consider mandating SEC-type reporting requirements for the Postal Service.

Such enhanced reporting is needed to provide financial transparency so that stakeholders are well apprised of the Service's financial situation and understand how future operating results may be affected by impending events, and so that changes in the Service's economic health do not come as a surprise to those responsible for or impacted by its performance. In addition, enhanced reporting will be even more critical if the Service obtains greater flexibility to set postal rates in a streamlined regulatory process that relies on rapid verification of compliance.

2. *Along the same line as my previous question, the Postal Service makes financial disclosures more frequently than private companies. However, the number of financial statements does not always result in financial transparency unless the reports are complete and accurate. Do you believe the financial reporting of the Postal Service reflects its true financial and operating conditions?*

The Commission noted that the Postal Service, as a public entity, is wholly owned by the American people, who, as the Service's shareholders, are due a regular and full accounting of the fiscal health and challenges facing this vital national institution. Service management and the Board of Governors, the Postal Rate Commission, Congress, and other stakeholders need to have a clear understanding of the Service's true financial condition as difficult transformation decisions are being considered. Therefore, it is important for the Service to lead by example in its financial reporting and disclosure.

The Postal Service issues annual financial statements that are audited by an independent auditor to ensure that they are in conformity with generally accepted accounting principles (GAAP). The Service has received clean opinions on those statements. Because its financial statements are audited by an independent outside auditor, we have not made a comprehensive assessment of the Service's financial statements. However, during the course of our work involving the Service's financial situation, we have noted some areas, such as the Service's reporting of its retiree health benefits obligation, in which the financial reporting of the Postal Service needs to be reviewed and revised.

First, the Service uses the pay-as-you-go basis of accounting, rather than accrual accounting, for its retiree health benefits obligation. Therefore the $54 billion unfunded obligation for retiree health benefits is not reflected on the Service's balance sheet. In our view, the enactment of P.L. 108-18 could be viewed as a significant event that triggers the need to reassess the accounting treatment currently used by the Service with respect to this obligation and even more strongly reinforces our view that full accrual accounting should be adopted for financial statement reporting purposes.[2] Accrual accounting would fully recognize this obligation in the Service's

[2] U.S. General Accounting Office, *Postal Pension Funding Reform: Issues Related to the Postal Service's Proposed Use of Pension Savings*, GAO-04-238 (Washington, D.C.: Nov. 26, 2003).

Enclosure

financial statements and thereby better reflect economic reality as the Service attempts to transform itself in order to respond to major operational and financial challenges. We understand that one likely effect of adopting accrual accounting for this obligation could be to significantly increase postal rates in the year of the accounting change. In our view, the Service should first assure that the accounting treatment and reporting of its retiree health obligation in its financial statements appropriately reflects the legal nature and economic reality associated with this significant obligation. Then, it should separately consider the impact on rates, which could be addressed by amortizing the obligation or phasing in any related rate effect over time.

Recently, the Service announced that it will remove its deferred pension liability and offsetting asset from its balance sheet. Although we have not yet assessed the Service's revised treatment of its Civil Service Retirement System (CSRS) pension obligation, we understand that the Service does plan to more fully disclose its CSRS pension obligation and discuss potential costs in notes to its financial statements. We believe that, at a minimum, it is important for the Service to disclose the amount and future contribution components of its CSRS pension obligations and the underlying actuarial assumptions, which will further enhance transparency in this area.

Second, as we testified, the Service needs to continue making progress in enhancing its financial transparency. As we reported last year, although the Service has traditionally provided a range of detailed financial and operating data to stakeholders throughout the fiscal year, its financial reports had provided only limited analysis and explanations to help stakeholders understand what has changed, why it has changed, and how these changes affect its current financial situation and expected outlook. We also found that the Service's quarterly reports were not consistent in format and content, making it difficult to make comparisons and analyze trends.[3] During the past 2 years, the Service has provided greater transparency in its periodic financial reporting by instituting quarterly financial reports that are posted on its Web site, expanding the discussion of financial matters in its annual report, and including more information in the financial and operating statements that are prepared for each accounting period.

In addition, starting in fiscal year 2004, the Service has further improved financial transparency by revising its accounting periods to coincide with each calendar month, rather than 4-week periods with different dates each year. As the Service pointed out in an informative public briefing held at the PRC, its monthly financial reporting will be compatible with the majority of private sector and government fiscal reporting, and its quarterly reporting will be aligned with the calendar quarters used by other organizations. Monthly reporting will also eliminate the "postal fiscal year" (i.e., 364 days in 13 accounting periods of 4 weeks) so that the Service's budget and financial results will be reported on the same government fiscal year basis used for its audited financial statements.

3. *The Commission calls for pay comparability standards. It also recommends indexing postal rates with caps. It seems to me that indexed postal rates would account for pay and other benefits. Therefore, would establishing pay comparability standards be redundant?*

---

[3] U.S. General Accounting Office, *U.S. Postal Service Actions to Improve Its Financial Reporting*, GAO-03-26R (Washington, D.C.: Nov. 13, 2002).

Enclosure

Pay comparability standards would not be redundant with changing the postal rate-setting process to a price cap system in which postal rates for market-dominant products would generally be limited by a cap such as the Consumer Price Index, largely because pay comparability standards should be established for different purposes. The pay comparability standard provides guidance to negotiators and arbitrators in the collective bargaining process. In contrast, the purpose of a price cap system is to enhance the Service's pricing flexibility while creating pressure for the Service to rein in spending and improve productivity.

Specifically, the Service is required by law to maintain employee compensation and benefits on a standard comparable to the compensation and benefits paid for comparable levels of work in the private sector. The Service and its major employee unions, however, have often disagreed with regard to how the comparability standard should be applied and have frequently relied on third-party arbitration to settle compensation-related disputes. As we testified, one option to clarifying the comparability standard could be to revisit the guiding principles incorporated into current law to more fully reflect all stakeholder interests and the Service's overall financial condition and outlook. These principles could specify that comparability includes total wage, compensation, and benefit costs, as well as the relationship of these costs to total costs, their impact on rates and revenues, and the Service's overall financial condition. Another option would be to delete pay comparability provisions from the statute, although this would raise the issue of what, if any, standard would remain to guide the collective bargaining process. If a pay comparability standard is retained, adherence to a comparability standard could call for restraint in postal wages and benefits for certain employees in the event that a wage and benefit premium is found. Conversely, to restore or maintain pay comparability, wages and benefits for other workers may need to be increased more than the increase in the price cap.

In addition, some comprehensive proposals for postal reform legislation have stated that nothing in the proposed law could interfere with the collective bargaining process, which means that the parties—or an external arbitration panel outside the parties' control—could impose contracts in which the cost of postal wages and benefits would rise faster than postal revenues if the revenues were limited by a price cap. For example, from fiscal year 1998 through fiscal year 2002, postal compensation costs reportedly increased 9.8 percent faster than the rate of inflation, as defined by the Consumer Price Index. These compensation costs accounted for more than three-quarters of postal operating expense over this period. If a price cap had limited price increases for market-dominant products over the same period, more than 90 percent of postal revenues could have been limited to growing no faster than the index (which might also have been reduced by a productivity offset, as the Commission proposed). Such an outcome could have resulted in large postal deficits unless the price cap system had provided for exigent rate increases above the cap.

However, the downside of a price cap system with exigent increases that could be triggered by labor contracts could be a lack of sufficient incentives to cut expenses; and thus, a lack of sufficient cost restraint, particularly if the Service can recoup costs by raising prices for captive ratepayers who send mail covered by the statutory monopoly. Even less cost restraint could apply if such a system were adopted while all comparability standards were deleted, since no statute would then provide a basis for limiting the growth of postal wages and benefits.
To underline the importance of this matter, postal workers comprise nearly one-third of the federal civilian workforce, and the criteria for setting wages and benefits for them, as for other federal employees, have long been regarded as a matter of public policy. In our view, the framework governing postal compensation involves tradeoffs among competing values, and

Enclosure

therefore it is appropriate that Congress should provide statutory guidance in this area. As Congress considers proposals for comprehensive change, it will be important to carefully assess the merits and practicality of changes to both the comparability standards and the regulation of postal prices.

4. *The President's Commission concludes that there is a need for enhanced managerial accountability and public policy oversight of a modern, flexible Postal Service. What in your view is the appropriate scope of regulatory oversight of the Postal Service, and what tools would be needed by an effective regulator to carry out that mission?*

In our view, strong, independent regulatory oversight is needed to ensure that public policy objectives established by law are implemented in accordance with congressional intent, particularly in the areas of postal rate setting and the reporting of the scope and quality of service. As we testified, key goals of regulatory oversight have been to protect postal customers against undue discrimination while restricting cross-subsidies. To accomplish these goals, particularly in a context that would give the Service more pricing flexibility, the Commission set forth a vision of independent regulatory oversight in which the outcome cannot be unduly influenced through the selective provision of information to the regulator. One key tool for Congress to consider, in the context of comprehensive postal reform, would be to give the regulator the power to subpoena information. Another tool could be to give the regulator the authority to compel the Service to collect the data needed for ratemaking and reporting on the quality of service, or update data it has collected, while giving guidance to recognize the burden and practicality of providing the data. High-quality data would be essential to periodic Service reports on the allocation of costs in accordance with form, content, and timing requirements determined by the regulator. Periodic reports could be a basis for after-the-fact reviews of postal rates, the adjudication of complaints, and any remedial action deemed necessary, such as further changes in postal rates to bring them into compliance.

5. *One of the guiding forces behind the expectation that private sector businesses operate efficiently is that general stockholders demand a return on their investment. The President's Commission expects that an appointed Board of Directors would fulfill this role in a transformed Postal Service. My question to you is what can be done to assure that the appointed members of the Board of Directors have a sufficient personal stake in the success of the organization that they will manage to maximize efficiency?*

As your question recognizes, it will be difficult for postal board members to have the same personal stake in the Postal Service as private sector directors, in part because it is common for private sector directors to own substantial shares of stock in the corporation. Recognizing the unique status of the Postal Service, if Congress wants to give postal board members a stake in the success of the organization, Congress could consider revising the statute to more closely tie the compensation of board members to the Service's performance. Because the Service is a governmental institution, it would be important to recognize other performance measures in addition to efficiency when defining organizational success.

Enclosure

6. *The Commission recommended that Congress clarify in statute the Postal Service's mission and role by defining universal postal service, including the activities of the Postal Service. Do you agree that it is Congress' role to make a legislative definition of universal service and outline the Postal Service's mission and role?*

The mission and role of the Postal Service are essential to setting public policy for a national institution that is a vital part of the nation's communications network and the hub of a $900 billion mailing industry. Defining the Service's mission and role will be critical as Congress considers modernizing the nation's postal laws to ensure that the Service can continue to successfully meet the formidable challenges it faces and continue to provide affordable and high-quality universal postal services. Indeed, greater clarity regarding universal postal service and the Service's mission and role should be the anchor for efforts to realign the Service's infrastructure and workforce to carry out its mission more efficiently and effectively. This is especially important given the many technological, telecommunications, transportation, and other changes and challenges that have occurred and will continue to occur that impact the nations' needs and the appropriate role for the Postal Service in the 21st century.

The Postal Service's repeated forays into money-losing initiatives provide additional impetus for clarifying the Service's mission and role. These ill-fated ventures have been cross-subsidized by postal ratepayers and created issues of unfair competition. The current Postmaster General has appropriately focused on the Service's core business of delivering the mail, and the Service has recently eliminated initiatives including electronic bill payment, an area served by an abundance of private sector offerings. However, as we testified, the time has come for Congress to clarify the Service's core mission to ensure continuity across changes in postal management.

7. *The Commission also recommended significant changes in the authority of the independent postal regulator versus the role of the proposed Postal Service's Board of Directors. What do you think should be the guiding principles in this area to establish the appropriate balance between the authority and responsibilities of the regulator and the Directors?*

Like other regulatory agencies, a postal regulator should be given sufficient authority and responsibility to ensure that congressional intent regarding public policy is carried out, while the Postal Service and its board should be given sufficient authority and flexibility to carry out the Service's mission of providing universal postal service. For example, as long as the Postal Service has a statutory monopoly on mail delivery, the postal regulator will need authority and responsibility in the postal rate-setting area to safeguard captive ratepayers and ensure fair competition. Similarly, as long as the Service has a mandate to provide mail delivery and postal retail services on a universal basis, it will need a legal framework that enables it to operate effectively and in a businesslike manner.

In our view, if the Service is to successfully operate in a more competitive environment, certain postal governance issues need to be addressed, including the qualification requirements for board members, the selection method, their roles and responsibilities, as well as their access to outside advisors and the resources at board members' disposal to perform their fiduciary responsibilities. Further, it is important for the board to be focused on strategic issues and to hold postal management accountable for results. Having a well-qualified, independent, adequately

Enclosure

resourced, and accountable board is critical for a major federal institution with annual revenues approaching $70 billion and approximately 829,000 employees.

We are supportive of sorting out the public policy, regulatory, and operational responsibilities in the postal sector, as well as giving both the Service and its regulator the authority to do their respective jobs. For example, as I testified, the definition of universal postal service is a public policy issue that is properly reserved to the Congress. Defining the key principles and related criteria for pay comparability is another area that might be more appropriately decided by Congress, rather than a regulatory entity, although the regulatory entity might have the need to operationalize and oversee implementation in this area. Moreover, the Commission concluded that the Postal Service must have greater flexibility to operate in a businesslike manner, including greater flexibility to set prices in a timely way. This change would be balanced by giving the postal regulator new authority to obtain cost information so that it could ensure that postal rates were in compliance and mandate appropriate corrective action if that proved to be necessary. This area illustrates the principle that providing the Postal Service with greater flexibility should be appropriately balanced by enhanced transparency and regulatory authority to enable effective oversight.

8. *The Postal Service recently reported that at the end of fiscal year 2003 its net income was almost $1 billion and with the recent legislative change in the USPS pension liability, the net income for FY03 was almost $4.4 billion. With what appears to be an improving financial outlook, do you believe that the Postal Service still belongs on the GAO high-risk list?*

We believe that the Postal Service's long-term outlook and transformation efforts still belong on our High-Risk List. Although the Service recently gained some financial breathing room because recently enacted legislation reduced its payments for its pension obligation, its long-term financial challenges remain, including an estimated $92 billion in liabilities and obligations, and the outlook for a growing financial squeeze caused by continued declines in First-Class Mail. Because First-Class Mail covers about 70 percent of the Service's institutional costs, forecasted declines would be difficult to recover from volume increases in other classes of mail. However, raising postal rates to offset this trend will likely accelerate the transition of mailed communications and payments to the Internet over the long term. Thus, dramatic improvements in the Service's efficiency are likely to be needed to maintain the quality and affordability of universal postal service. The Service would need to become a much leaner and more flexible organization and rightsize its network of mail processing and distribution facilities. Comprehensive reform of the nation's postal laws would also be necessary to facilitate change in these areas.

Under the leadership of Postmaster General Potter, the Postal Service has begun to make progress in addressing its transformation challenges by cutting costs, improving productivity, reducing the size of its workforce, and closing some excess facilities. We are optimistic that further progress can be made within existing law. However, we also believe that fundamental, comprehensive transformation will require congressional support and action. Shared sacrifice is never popular, and stakeholders have yet to reach a consensus on complex and sensitive postal issues. It is important to establish mechanisms so that tough choices are made in a timely manner. If trends continue in areas such as increasing competition, changing demographics, rapidly changing technology, and the decline in First-Class Mail volume, failure to make tough

Enclosure

choices now would likely result in more dramatic and frequent rate increases later, with significant consequences for the Service and its customers. Before we remove the Postal Service's long-term outlook and transformation efforts from our High-Risk List, we need to see the following types of actions:

- Development of an integrated plan to optimize its infrastructure and workforce and progress toward implementing the plan.

- Implementation of viable strategies for addressing the Service's long-term financial challenges, including dealing with the anticipated decline in First-Class Mail volume, and addressing its unfunded obligations, including its retiree health benefits obligation.

- Enactment of comprehensive postal reform legislation. Some of the key areas that need to be addressed as part of comprehensive reform legislation include clarifying the Service's mission and role; enhancing governance, accountability, oversight, and transparency; improving regulation of postal rates; and making human capital reforms.

9. *Along similar lines, do you believe the Service is making sufficient progress in implementing its Transformation Plan, and if not, what areas concern you?*

Under Postmaster General Potter's leadership, the Service has made progress in a number of areas, and we have no doubt that Postmaster General Potter is committed to making further progress. For example, in recent years the Service has cut its costs and improved its productivity. Further, the Service has reduced total work hours and the number of its employees while absorbing annual increases of 1.8 million delivery points, which has led to annual increases in the Service's productivity. In addition, the Service has begun to reduce excess infrastructure by closing a number of annexes to mail processing facilities. Aided by recent pension legislation, the Service has recorded large operating surpluses and repaid some of its debt, which had been approaching its statutory limit. Meanwhile, the timeliness of First-Class Mail service has increased to record levels, as measured from collection box to final delivery in 463 ZIP Codes from which most First-Class Mail originates and to which it is destined.

Despite these and other accomplishments, we have concerns in several key areas, including the following:

- To date, the Service has not made public a comprehensive infrastructure rationalization plan and has had limited engagement with stakeholders who may be affected. Since the Service published its Transformation Plan in April 2002, the Service reports that it has begun to optimize its network, but the Service has been reluctant to divulge its network optimization plans, including the timing and funding needs associated with these plans, to Congress or its stakeholders. Therefore, we were pleased that the Service agreed to develop a comprehensive plan to optimize its infrastructure and workforce, in collaboration with its key stakeholders, and make it publicly available. Given the Service's track record, we are concerned that strong congressional encouragement and close oversight will be necessary to facilitate meaningful stakeholder consultation and the development of a sufficiently detailed plan for Congress and other stakeholders to understand the Service's vision and plans for its

infrastructure.

- It may be difficult for the Service to obtain adequate funds to address its long-term capital needs, including modernizing its aging network of postal facilities, without significantly increasing rates or debt. In the Service's September 30, 2003 report to Congress on its proposals for using savings resulting from P.L. 108-18, the Service indicated that it can finance capital investments related to upgrading existing assets and the investment needed to implement transformation initiatives through inflation-based rate increases. We are concerned that the Service's financing plan may not be adequate to provide for its capital investment needs, because historically, the Service has found it problematic to finance its capital needs with operating revenues. Thus, it has often resorted to borrowing to finance its capital needs. To date, the Service has said little about how it intends to address this challenge.

- We are also concerned about the potential financial impact of a continued decline in First-Class Mail volume on the Postal Service, coupled with above-inflation increases in the costs of postal compensation and benefits. Although a rate increase is expected in 2006, as a general matter, rate increases will likely accelerate the diversion of mail to electronic alternatives.

- We continue to be concerned about the need for greater financial transparency by the Postal Service. We have recommended that the Postal Service improve its transparency, and to the Service's credit, it has made progress in providing greater transparency on its financial results and outlook. However, we agree with the Commission that more progress can and should be made. In this regard, the Service's steps toward implementing voluntary financial reporting to the SEC will need to be closely monitored.

- In our view, the Service's accounting treatment of its retiree health benefits obligation does not reflect the legal nature and the economic reality of this significant obligation. We continue to believe that the time has come for the Service to formally reassess how it accounts for and discloses this very significant financial obligation. In our view, given the legal nature, economic substance, and stakeholder implication of this obligation, the Service should account for retiree health costs and related obligation in its financial statements on an accrual basis. We recognize that a change to accrual accounting could have a significant impact on rates. However, as we noted in our recent report on the Service's proposed use of pension savings, the Service could work with the PRC and other stakeholders to determine how best to phase in such a change for ratesetting purposes to mitigate the immediate impact on ratepayers.

10. The Commission Report discusses the need to implement a pay for performance system. Could you provide us with a few examples of private sector companies with unionized workforces that have successfully implemented performance-based compensation systems?

While not specifically addressing their approach with unionized workforces, we reported that an underlying principle among private sector organizations cited as leaders in human capital

management is to use their performance management systems to link performance to results.[4] These organizations provide incentives and hold employees accountable for contributing to the achievement of missions and goals and reward those employees who meet or exceed clearly defined and transparent standards of high performance.

Federal agencies have implemented pay for performance through the Office of Personnel Management's personnel demonstration authority under the Civil Service Reform Act of 1978. Among other things, this law requires agencies proposing demonstration projects to consult with unions and employees. Several implemented projects involve pay-for-performance systems covering employees represented by unions. For example, the National Institute of Standards and Technology project, established in 1986 and made permanent in 1996, has about 3,000 participants including union members from the International Association of Firefighters, International Association of Machinists and Aerospace Workers, and American Federation of Government Employees. Also, the Department of Defense's Civilian Acquisition Personnel Demonstration Project, established in 1996, has 6,500 employees as of February 2003 including union members from the American Federation of Government Employees, the National Federation of Federal Employees, and the National Association of Government Employees.

11. The challenge of trying to implement performance-based compensation systems is controversial for many federal agencies. Do you believe that performance-based compensation systems should be applied for all postal employees, and do you have any suggestions to how such a system might apply to postal employees who have their compensation set through collective bargaining?

We strongly support the need to expand performance-based compensation systems in the federal government, including employees whose pay is set through collective bargaining at the Postal Service. Over the years, the Service's major labor unions have consistently opposed extending a pay-for-performance system to craft employees. Union concerns also include tying employee compensation to results that depend in part on external events beyond their control as well as on the quality of postal management. It is reasonable to question whether a pay-for-performance system could be agreed on, implemented, and successful in the face of strong opposition of national and local union leaders. Union concerns are understandable because past history has led some union officials to question whether a pay-for-performance system could be successfully implemented within the Postal Service.

In fiscal year 1995, the Service implemented a pay-for-performance system for its executives, managers, postmasters, supervisors, and other nonbargaining employees. This system was discontinued in fiscal year 2002, in part because of concerns that large payouts were made when the Service was recording large deficits. The Service revised its merit-based pay program for its executives and officers in fiscal year 2002 and revised its merit-based pay program for its postmasters, managers, and supervisors in fiscal year 2004.

Given the concerns that led to the overhaul of the Service's previous merit-based pay systems, it is important that these systems be evaluated to ensure that they are administered fairly and

[4]U.S. General Accounting Office, *Human Capital: Key Principles From Nine Private Sector Organizations*, GAO/GGD-00-28 (Washington, D.C.: Jan. 31, 2000).

provide meaningful incentives. Such incentives would require valid measures that correspond with individual and organizational performance goals, as well as targets that are sufficiently challenging that they are not met automatically. In this regard, it is important for the performance measures dealing with cost savings and productivity to be tied to real savings and productivity improvements. Namely, productivity increases should result in absolute cost reductions or creation of additional capacity where such capacity is needed and can be put to effective use in an efficient manner.

Although we support extending pay for performance to employees covered by collective bargaining, as I said during the Committee's November 5, 2003 hearing, pay for performance may not be appropriate for all types of positions. The nature of an individual's roles and responsibilities needs to be considered in deciding whether pay for performance is appropriate, and if so, what type of performance-based compensation would be best suited. For example, at least some performance standards and measures for window clerks are likely to be different from performance standards for letter carriers, mail handlers, and other employees who work in mail processing facilities. Involving the Service's unions will be crucial to the success of any new initiative related to performance-based compensation. Obtaining union cooperation and support through effective labor-management relations can help achieve consensus on changing compensation systems, avoid misunderstanding, and more expeditiously resolve problems that occur. We have previously reported examples of how agencies engaged employee unions.[5] They

- develop and maintain an ongoing working relationship with unions and found that an ongoing relationship enhanced communication,
- document formal agreements to serve as a foundation setting forth the manner in which labor and management would work together,
- build trust over time to create an environment of openness in working cooperatively with unions, and
- participate jointly in making decisions by involving unions and incorporating their input into proposals before finalizing decisions.

(543090)

[5]U.S. General Accounting Office, *Human Capital: Practices That Empowered and Involved Employees*, GAO-01-1070 (Washington, D.C.: Sept. 14, 2001).

Dear Senator Collins:

I am writing you as president & CEO of American Business Media, an association whose members publish the nation's leading business periodicals. It is ABM that called for a Presidential Commission to review the Postal Service seven years ago. We testified and submitted written comments to the Commission, with two consistent messages: (1) **the Postal Service must be given the means to control costs**, and (2) **given the fact that the USPS is a monopoly, there must be an independent regulator to guard against excessive rate increases.**

The Commission's report addressed these two issues. Now, the focus is on Capitol Hill. American Business Media urges Congress to recognize that postal reform will be meaningless for most mailers if the Postal Service is not given the power to control costs. The woes of the Postal Service cannot be cured only by changes—such as pricing flexibility—that permit it to raise revenues. Rather, success requires the taking of bold steps to permit it to control costs.

American Business Media's comments to the Commission contended that its members, as captive customers, should not be exposed to a *de facto* monopoly Postal Service that is permitted to raise rates without the prior review of an impartial and independent body, such as the Postal Rate Commission. No other government-endorsed monopoly has that luxury.

Others contended, however, and the Commission ultimately agreed, that the present rate-setting process is too time-consuming. The Report recommends a system in which prior review of rates is necessary only for "non-competitive services" *and* only when the Postal Service proposes a rate increase in excess of the so-called "ceiling" established by the Postal Regulatory Board. That "ceiling" is not a true ceiling, for the Postal Service is free to impose increases that exceed the ceiling. Because the Report suggests no standards for review, because it recommends a 60-day time limit on that review, and because the Postal Service must as a practical matter give mailers at least 60 days' notice of nearly all rate changes in any event, the recommendation in the Report gives American Business Media members little comfort.

But despite our misgivings, American Business Media can support the totality of the recommendations of the President's Commission—as a package. We can do so **only** because adoption of those recommendations would lead to essential cost controls.

American Business Media opposed most of the postal reform bills that were introduced in the House of Representatives in the past few years, for they would have done little to enhance the ability of the Postal Service to control costs. We were unwilling to accept the concept of a Postal Service with out-of-control costs and the ability to raise rates at will for its captive customers.

The Commission's report, on the other hand, pairs rate flexibility with cost control. Although we remain concerned that the rates paid by our members will undergo little or no meaningful review, we can accept that risk if the Postal Service is truly permitted to close facilities and control its costs.

American Business Media appreciates the difficulty of enacting legislation that addresses these issues in an effective manner, but heavy lifting is essential if the weight of excessive postal costs is to be lifted from the backs of *all* postal patrons, not just the largest. It would be a grave mistake to dismiss the Commission's most controversial recommendations, accept the remainder and declare that postal reform has been accomplished. Congress must reach for the high-hanging fruit, or it will lose an opportunity to prevent a crisis that can inflict serious harm on the nation's economy.

Sincerely,

Gordon T. Hughes
President & CEO
American Business Media

675 Third Avenue
New York, N.Y. 10017-5704
www.americanbusinessmedia.com

Gary M. Mulloy
Chairman and Chief Executive Officer

November 4, 2003

Honorable Susan M. Collins
Chairman, Senate Government Affairs Committee
Dirksen Building, Room SD-340
Washington, DC 20510

Re: Reform of U.S. Postal Service

Dear Chairman Collins and Members of the Senate Committee:

Thank you for inviting comments from stakeholders as part of the November 5th hearing of record. I am the Chairman and Chief Executive Officer of ADVO, Incorporated, the largest full-service targeted direct marketing services company in the United States. Our shared mail advertising programs reach nearly 105 million U.S. households on a weekly and monthly basis. We service more than 26,000 customers and distribute more than 28 billion pieces of advertising on their behalf each year. We are best known for our America's Looking For Its Missing Children program which we launched in 1985 and which has safely recovered 130 children.

As requested, I will make some comments about the report of the President's Commission on the Postal Service later in this letter.

Before addressing the Commission's report, however, I would like to comment upon the overall issue of postal reform. Let me first of all state clearly that I believe that the true purpose of postal reform should be to preserve and protect the Postal Service as a truly critical national resource for all U.S. citizens and our economy. I believe that this will be best done by providing the Postal Service with an economic structure that empowers and encourages it to be an efficient and effective competitor in its marketplace. Therefore, the very first step in postal reform should be to ensure that past, current, and future statements of the economic performance of the Postal Service truthfully and fairly present its business results. Unfortunately, proper assessment of this performance has long been prevented by erroneous and unfair reporting of postal employees' retirement benefits.

I thank you for your support of the Postal Civil Service Retirement System Funding Reform Act (P.L. 108-18) and congratulate you on its successful passage. This recognition of the major overstatement of the pension liabilities of the Postal Service is a first step in correcting the visibility of the true financial performance of the United States Postal Service.

ADVO Inc. The ADVO Center One Univac Lane Windsor, CT 06095-0755
Telephone (860) 285-6112 FAX: (860) 285-6412

Additionally, the resulting rate stability brought about by that law has allowed my company and many others to invest in the future and work to grow the mailing industry. Continued rate stability (and the job growth and other benefits it brings) is achievable if all retirement issues are addressed together. Such a resolution of these significant areas of expenditure will be a major step in presenting the Postal Service's financial condition in a more truthful and measurable way, and, therefore, provide the focus necessary to prioritize and understand all other critical reform issues.

Retirement Issues:

As you know, for years the Postal Service has been forced to pay for a series of pension related overcharges. The cost of these overcharges is at least the $103.1 billion reported by the GAO in January 2003. These overcharges were the result of erroneous assumptions that date back as far as 1970 and remained unchallenged until 2002. P.L. 108-18, while an enormously important step forward, was only a partial and temporary solution. Congress can best succeed in accomplishing long-term, broad reform if it begins with an accurate and complete understanding of the Postal Service's financial condition. This requires immediate attention to one of its largest single expense items: employee retirement expenses.

Actions must be taken now to address all of the United States Postal Service's retirement issues: the CSRS overpayments (which are scheduled to be escrowed under P.L. 108-18), benefits accrued due to service pre-1971 (when the Postal Service was created) and an underfunded obligation for healthcare benefits for its retirees. In addition, P.L. 108-18 created a new issue regarding benefits earned during military and volunteer service which must be resolved in this total context (and which the President's Commission stated "The portion of CSRS retirement benefits accrued by postal workers through service in the U.S. military should be financed by taxpayers, not ratepayers. Congress should return responsibility for these benefits to the Department of the Treasury which, until recently, paid these obligations through appropriations.") I believe that the proper action for Congress to take is to resolve all of these retirement issues at one time as the first step in postal reform.

Effective legislation would include the following:

> CSRS Fix: Use the funds currently required to be escrowed (the savings realized from P.L. 108-18) to extend the current rate freeze. The Postal Service has stated it will need to raise rates dramatically if the CSRS savings remain in escrow.
>
> Military Pensions: As recommended by the President's Commission, responsibility for benefits earned as a result of military service should be the responsibility of the Treasury, not the Postal Service and its consumers and customers. Relieving the Postal Service of this obligation will improve its ability to address the retiree health care liability.

Carryover Obligations: The Postal Service (and its consumers and customers) should be relieved of any obligation to pay benefits accrued due to employment before the 1971 creation of the Postal Service. A full, accurate, and actuarially sound accounting needs to be made of these obligations, but it is possible that the Postal Service will be able to fully fund the retiree health care liability if it is relieved of all pre-1971 and military/volunteer obligations.

Retiree Health Care Benefits: The Postal Service is responsible for health care benefits for its retirees. The future liability for the health care benefits is estimated between $40 billion and $50 billion. The GAO and others have called for the USPS to properly account for, and possibly pre-fund that liability. The Postal Service and its customers and consumers cannot afford to address this liability unless there is total resolution of all other retiree obligations (CSRS overpayments, military/volunteer service, and pre-1971).

These actions are necessary for the Postal Service to remain viable as further reform is being considered by the United States Congress.

Reform:

ADVO advocated for the appointment of a commission to study the Postal Service and applauds President Bush's appointment of a distinguished panel. The report of the Commission is a solid framework for comprehensive reform and we urge the Congress to move forward expeditiously on reform legislation.

We are pleased the Commission has proposed overhauling and expediting the rate making (price setting) process. The current process is lengthy, expensive for all parties involved, and fraught with uncertainty which impedes the ability to plan. We would recommend that adequate consideration be given to the opportunity for full review and the due process rights of the participants when Congress passes legislation to make the process more efficient.

We also support the proposal to create a price cap for non-competitive products tied to the rate of inflation. Rate increases should be kept below the rate of inflation. Predictable rate increases will allow for better planning by the Postal Service's customers and lead to more business (and revenue) for the United States Postal Service – and a stronger mailing industry and overall economy.

An important tool for bringing about growth is encouraging the Postal Service to enter into contracts (Negotiated Service Agreements) with its customers. The Commission wisely endorsed this idea as a method of generating increased volume for the United States Postal Service. To date, only one NSA has been approved – and that was after months of litigation before the Postal Rate Commission. The Postal Service should be given more freedom to reach such agreements, and their approval time must be shortened.

We also support the concept of a corporate-style board with broad authority. This would give the Postal Service an additional tool in its search to become, and remain, competitive and responsive to the needs of its customers.

Finally, we believe that the Commission's workforce recommendations deserve attention and consideration. Providing employees with fair wages and benefits is a cost of doing business for every organization and the Postal Service is no exception. There is no need to penalize or punish workers in order for the Postal Service to be financially successful. On the other hand, Postal Service management must be given the appropriate tools to manage their costs so that they remain viable in an increasingly competitive environment.

The Future of the USPS and the Mailing Industry:

As I stated when I testified to the President's Commission, ADVO is committed to doubling its business in the next five years. We see tremendous potential for growth in print advertising delivered directly to consumers homes. Currently, half of our topline revenue ($500 million per year) covers our postal expense. I believe the Postal Service can, and should, be our partner in the significant growth we are planning if its long-range economics are truly competitive in the marketplace. This, I believe, must be the true objective of postal reform legislation.

Once implemented, the recommendations of the President's Commission will help create a market focused Postal Service committed to universal service, a competitive pricing strategy and modern business practices. The United States Postal Service's culture will gradually be transformed from an operationally driven organization to one that is focused upon serving its customers by expanding services that grow top-line revenue. Overall, this would serve to protect a truly critical national resource by empowering it to improve its economic position and operation.

Again, thank you for the invitation to submit comments. My company and I are available to you at any time should you have questions or require other information or assistance as you deliberate these extremely important issues.

Sincerely,

Gary M. Mulloy

November 18, 2003

The Honorable Susan M. Collins
Chairman
Senate Committee on Governmental Affairs
340 Dirksen Senate Office Building
Washington, DC 20510-6250

Dear Chairman Collins:

Thank you again for your energetic and timely response to the challenges facing the national mail delivery network. Your leadership in addressing the payment schedule for postal retiree benefits in S.380 granted a measure of stability for the US Postal Service that we sincerely appreciate. The nonprofit community of America thanks you and your fine staff for a job well done.

As we have all learned during the recent hearings of your Committee, this new measure of fiscal stability offers only temporary relief. As pointed out by the members of the President's Commission on the USPS, significant reforms of the laws that guide and govern the Postal Service must be embraced if we are to protect the concept of an affordable postal service that offers universal service at a fair price to our citizens.

As we have been in the past, the Alliance of Nonprofit Mailers stands ready to work with you and your colleagues on the Senate Committee on Governmental Affairs — and your colleagues in the House of Representatives — to address meaningful postal reform in the Second Session of the 108th Congress.

Most importantly, we recognize the best chance for survival for the US Postal Service rests in controlling costs and "right-sizing" the postal network to stay in pace with shifting volume patterns. **Therefore, we urge the Congress to address the important issues surrounding the escrow fund associated with the CSRS reform measure and the assignment of military service time costs for those USPS retirees covered in the CSRS plan.** A fair and rapid resolution of these fiscal uncertainties might allow the USPS to stretch-out the current rate cycle and allow mailers and consumers an opportunity to recover lost volumes and provide robust growth to the Postal Service.

The President's Commission recognizes these funding concerns and also offers a series of carefully considered proposals that represent good starting points for meaningful postal reform. We agree that Congress should address the most pressing issues as soon as possible:

- The necessity for greater accountability, oversight and transparency in the Postal Service. The Commission recommended a series of approaches to addressing the transparency of the USPS — including the imposition of an SEC-type of financial reporting. The USPS can unilaterally address many of the recommendations made by the President's Commission without the necessity of legislation. We also believe that new changes to the postal ratemaking process imposed by the Postal Rate Commission (PRC) in the recent rulemaking proceeding (RM2003-3) will also introduce a new measure of transparency to rate case proceedings.

1211 Connecticut Ave, NW, Suite 620, Washington, DC 20036-2701 • 202-462-5132 • *alliance@nonprofitmailers.org*

- Modest changes in the ratesetting process. We remain concerned with any legislative approach that would diminish objective oversight of the USPS in the ratesetting arena. While we remain supportive of USPS flexibility to test market new products or services or offer special, negotiated rate or service options to qualified mailers, we believe that these can be accomplished under current law. We question why the USPS has been slow in proposing these types of flexible arrangements. We also recognize that new PRC rules addressing transparency in rate case filings (RM2003-3) should also provide new opportunities to shorten the time required to litigate omnibus postal rate cases. Other legislative remedies should be considered; for instance, the PRC should be granted subpoena authority in rate case and classification proceedings. Also, we support the imposition of rate caps and bands to limit and control the size of future postal rate increases imposed by the USPS.

- The governance structure of the USPS. We have no quarrel with the proposals of the President's Commission relative to the alteration of the USPS Board of Governors.

- Fair improvements to provide flexibility for USPS management in realigning the postal network, labor force and other resources. Certainly, these are among the more controversial of the Commission recommendations. However, we are confident that some agreement can be reached with USPS management and representatives of postal labor that will address these important issues.

Some of the more productive reforms are already underway at USPS Headquarters. At the urging of the Senate Committee, the USPS has embarked on an aggressive Transformation Plan that will likely address many of the recommendations of the President's Commission. The Committee should continue to encourage USPS leadership in this direction and request continuous updates on the direction and progress of the transformation efforts.

America's associations, colleges, universities, churches and charities rely upon the mail to raise funds and disseminate information to our citizenry. Your work in stabilizing postal finances and leading the call for an objective Presidential Commission to study the future of the Postal Service is most appreciated by the nonprofit community.

We thank you for your past support of our community and look forward to working with you and your staff in the days ahead.

Sincerely,

Neal Denton
Executive Director

1211 Connecticut Ave, NW, Suite 620, Washington, DC 20036-2701 • 202-462-5132 • *alliance@nonprofitmailers.org*

AMERICAN FOREST & PAPER ASSOCIATION
GROWING WITH AMERICA SINCE 1861

Senate Committee on Governmental Affairs
November 5, 2003

The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability

---

American Forest & Paper Association
Statement for the Record:

The U.S. Forest Products Industry Welcomes Findings of the Presidents Commission on the United States Postal Service

The American Forest & Paper Association (AF&PA) strongly supports postal reform initiatives that will encourage the Postal Service to improve service, reduce costs, and respond to a changing marketplace. AF&PA is the national trade association of the forest and paper industry and represents more than 240 member companies and related associations that engage in or represent the manufacturers of pulp, paper, paperboard and wood products. AF&PA and the allied paper products industry (composed of pulp, paper and paperboard mills as well as plants that convert primary paper into envelopes, stationery, and boxes) provide the raw materials for paper-based communications – much of which is transmitted via the Postal Service.

AF&PA welcomes the comprehensive final report issued to President George W. Bush on July 31, 2003 from the President's Commission on the United States Postal Service. AF&PA commends the Presidential Commission's progress and commitment over the last seven months to provide comprehensive analysis and detailed recommendations that could substantially reform and modernize a system that has not altered its governance laws in more than 30 years.

As stated in the Commission's report, universal postal service remains vital to the nation and its economy at the dawn of the 21st century. The paper industry and its major customers are inextricably linked to postal shipments. Changes in postal shipments strongly correlate with corresponding shifts in printing and writing paper demand. The more printing and writing paper consumers purchase, the more weight in mail moves through the system. In turn, larger volumes of mail help increase Postal Service revenues and create opportunities for economies of scale.

In 2001 alone, almost 10 million tons of mail – about a third of U.S. demand – was shipped through the three main classes of mail. The vast majority of this mail, estimated at over 7 million tons annually, was in the form of printing and writing paper. Thus, the decreased

1111 Nineteenth Street, NW, Suite 900 ▮ Washington, DC 20036 ▮ 202.463.2700 Fax: 202.463.2424
America's Forest & Paper People® - Improving Tomorrow's Environment Today®

demand for mail and subsequently printing and writing paper has indirectly affected the upstream portions of our industry.

Whenever mail volume declines, cost increases tend to exceed revenue increases. This, in turn, forces the Postal Service to raise rates. Yet in recent years, the more the Postal Service has raised rates the more volume it has lost, creating a declining financial spiral. AF&PA data shows that shipments of mail trend downward as a result of postal rate increases. One example of this was in 2001-2002 when the postage increase for periodical shipments increased by 24%. By the first postal quarter of 2003, shipments were down more than 20% from the same quarter in 2000 – eight straight quarters of decline. This is equivalent to a loss of demand of almost half a million tons of paper on an annualized basis, three quarters of which is estimated to be magazine paper.

As the Postal Service has experienced a recent decline in mail volumes, AF&PA's members and their customers have felt the upstream impact. Since 1997, paper companies have closed 98 mills and lost about 50,000 jobs. The decline in paper mail processed through the Postal Service is one factor accounting for these losses.

Given an ever-increasing competitive environment that is impacting both the postal service and the forest products industry, it is clear that the Postal Service cannot restore its financial health through raising rates. Rather, the revitalization of a viable postal service – and of the printing and writing industry – is dependent on the development of a plan that increases efficiencies, reduces costs and maximizes volume and revenue.

In February 2003, AF&PA expressed its support for the Presidential Commission's charter and its important work. Moreover, at that time, AF&PA cited the following principles for reform of the Postal Service.

- Support for universal service, continuing delivery to every household in the country;
- Enhancement of the Postal Service's ability to reduce costs and achieve the lowest combined cost for processing and delivering mail including opportunities for expanding work-sharing and pursuing additional private sector partnerships, and adjusting the size of its workforce and network;
- Improvement of financial transparency and measurability to support a less onerous and expensive rate process and to support employee incentives;
- Investment in technology to enhance operational efficiency; and
- Improvement in productivity to encourage employee incentives. The Postal Service should have the flexibility to pay competitive wages, measure job performance, and reward and penalize accordingly.

Right-sizing the infrastructure and workforce should be a guiding principle for positioning the Postal Service to be competitive in the future so as to achieve volume maximization and revenue generation while effectively reducing costs. AF&PA thinks it is particularly important for the Postal Service to be able to close or consolidate processing facilities without getting involved in the political process. In addition, the Postal Service should take full

advantage of the attrition opportunity occurring between now and 2010 to right-size and realign its workforce with minimum displacement of people.

The President's Commission states, "Taxpayers, not ratepayers, should finance military pensions." AF&PA agrees with this statement, and, therefore, believes that the responsibility for funding Civil Service Retirement System benefits relating to the military service of Postal Service retirees should be returned to the Department of the Treasury.

AF&PA agrees with the analysis of the Presidential Commission that far more emphasis must be placed on restoring fiscal stability not by ratcheting up rates or scaling back service, but by aggressively rooting out inefficiencies throughout the Postal Service. Furthermore, AF&PA agrees with the Commission that the Postal Service needs a new business model for the modern world and the changing postal needs of the nation.

The comprehensive conclusions and recommendations outlined by the Commission are a good starting point for the Postal Service to begin to implement the changes that do not need Congressional approval. We are encouraged with their progress to date on the Transformation Plan and believe the Commission's recommendations provide additional avenues for improvement.

At the same time, we believe Congress must also take action to update and modernize the governing laws of the Postal Service. The Commission has given Congress much to consider and, importantly, much to act upon. AF&PA will be examining in more detail the impact of these conclusions and recommendations on the forest products industry during the coming months.

Overall, AF&PA supports the conclusions of the Commission that the Postal Service must be freed from unnecessary and outdated statutory constraints. Additionally, the forest products industry believes that all businesses can benefit from cutting costs, better management of assets, increasing organizational effectiveness, shaping more partnerships, offering greater financial transparency, and rewarding the workforce for superior performance. Realizing that the Postal Service is a $67 billion organization, the 11th largest U.S. enterprise by revenue, the second largest employer in the nation, and the hub of a thriving domestic mailing industry, reform is essential to enhance the value of the mail in the modern context and deliver a capable, sophisticated, and leading-edge 21st century national postal endeavor.

In conclusion, the forest products industry echoes the charge of the Commission that it is imperative that this nation embraces the future and makes the tough choices to preserve Universal Mail Service. AF&PA welcomes the opportunity to work with the Congress, the Postal Service, the Administration, and other interested stakeholders to ensure that there is a viable Postal Service in the United States.

For additional information, contact Donna Harman, 202-463-2476.

AMERICANS FOR TAX REFORM

Grover G. Norquist President

November 3, 2003

The Honorable Susan Collins
Committee on Governmental Affairs
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairwoman Collins:

As the Senate Governmental Affairs Committee prepares to examine the issue of reforming the United States Postal Service, I wish to address several concerns on behalf of the American taxpayer.

With more than 750,000 employees (closer to 900,000 when including part-time employees) the USPS continues to be an oversized, bloated government enterprise. Labor costs and inefficiency continue to inflate the price of postage, and we are seeing indications that the USPS may be either unable to honor its obligations under the Postal Civil Service Retirement System Funding Reform Act of 2003 not to raise the price of postage before 2006, or poised to dramatically raise rates shortly thereafter. With these factors in mind, the USPS desperately needs to cut its workforce.

The USPS should also be restricted to the limited mission set out for it in the Postal Reorganization Act of 1970. The USPS continues to attempt expansion into competitive markets already well served by the private sector. The Postal Service's revenue shortfalls and inefficiencies cannot and should not be remedied by attempting to compete with private businesses.

In addition to staying out of competitive markets, the USPS should also maximize the use of the private sector, which can do much its work far more efficiently. Costs can be reduced, efficiency improved and mail made more affordable by use of partnerships, outsourcing and worksharing.

Finally, the USPS should not be granted so-called "pricing flexibility," as some have advocated. Under the current rate-setting process, we have seen incessant postage rate hikes in the face of insolvency, mismanagement and foolish business ventures. For an agency that has demonstrated such disrespect for taxpayer dollars, it should be harder, not easier, to raise postage rates.

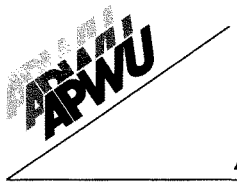
The only sure way to reform the USPS is to stop treating the symptoms with ever-increasing postage rates, and instead to treat the disease by understanding that the USPS' financial problems are a result of overspending and overreaching, rather than a lack of revenue.

All we need is a road map to that destination. You can help draw it.

Onward,

Grover Norquist

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



American Postal Workers Union, AFL-CIO

1300 L Street, NW, Washington, DC 20005

William Burrus
President
(202) 842-4246

National Executive Board
William Burrus
President

Cliff "C.J." Guffey
Executive Vice President

Robert L. Tunstall
Secretary–Treasurer

Greg Bell
Industrial Relations Director

James "Jim" McCarthy
Director, Clerk Division

Steven G. "Steve" Raymer
Director, Maintenance Division

Robert C. "Bob" Pritchard
Director, MVS Division

Regional Coordinators
Sharyn M. Stone
Central Region

Jim Burke
Eastern Region

Elizabeth "Liz" Powell
Northeast Region

Terry R. Stapleton
Southern Region

Omar M. Gonzalez
Western Region

November 5, 2003

The Honorable Susan M. Collins, Chairman
Senate Committee on Governmental Affairs
340 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Report of the President's Commission on the United States Postal Service

Dear Chairman Collins:

Thank you for providing the American Postal Workers Union, AFL-CIO (APWU), the opportunity to comment for the record on the Report of the President's Commission on the United States Postal Service. As the collective bargaining representative of more than 330,000 postal employees, we speak for workers who are dedicated to the public service mission of the Postal Service and who have a vital interest in postal reform.

We understand that we will be permitted an opportunity to testify before the Governmental Affairs Committee about the Commission's report, and look forward to doing so. If legislation to amend the Postal Reorganization Act of 1970 is introduced, we anticipate that you will conduct hearings that are much more narrowly focused, and we respectfully request an opportunity to provide further testimony if that occurs.

Before commenting on the specific recommendations of the Commission, I wish to state at the outset that the APWU opposed the creation of the Commission. We believed that the justification for the Commission was flawed and that the changes necessary to improve the Postal Service business model were within the scope of existing authority. In retrospect, we believe that our criticisms were well-founded.

The Commission and its staff worked very hard to comprehend the issues and to give interested parties an opportunity to present their views. The Commissioners are to be commended for their efforts. In the time permitted for its work, however, the Commission was able to analyze only those issues advanced by stakeholders whose interests differ from the concerns of the

American public. The few contractors used by the Commission to evaluate particular issues were themselves operating on such short timetables that they could do little more than survey existing opinions or report on existing research. As a result, and as we predicted, the report provides no useful insight into postal operations, and no helpful guidance on the public policy issues involved in postal reform.

Our most serious criticism of the Commission is that it systematically failed to consider the potential impact of postal reform on individuals and small businesses. In fact, the Commission excluded from its conclusions and recommendations the results of a public-opinion survey conducted at its behest that shows that Americans have an overwhelmingly favorable view of the Postal Service and see no need for sweeping changes.

Our concern about the lack of input from ordinary citizens and small businesses was well-expressed by the Honorable William Clay Sr., former Chairman of the House Committee on the Post Office and Civil Service. Speaking on behalf of the Consumer Alliance on Postal Reform (CAPS), Mr. Clay stated:

> "Quite frankly, I have been disappointed that consumers have generally not been heard from at your hearings. ... You have heard from vendors, large mailers, marketers, union representatives, and the Postal Service itself, but the voices of individual Americans who rely on the mail during the course of their daily lives have been missing.
>
> "On behalf of those individual American consumers that CAPS and its members represent, I have a simple and straightforward message for this Commission: We are opposed to any efforts that would weaken universal mail service at uniform rates."

We also faulted the Commission for its refusal to review the USPS rate-setting and implementation process. It is inconceivable for a review of overall operations to exclude an analysis of the Postal Service's revenue stream and the setting of rates among classes of mail.

Input into the Committee deliberations was dominated by the large mailing industry, whose interests differ widely from the average citizen's. As a result, the final report simply cannot claim to represent an effort to improve services to the American public.

Specific Commission Recommendations Opposed by the APWU

Our union has publicly opposed those recommendations of the Presidential Commission that would:

- Give a politically appointed Postal Regulatory Board the authority to "review and refine" the scope of universal service; "clarify and refine" the scope of the postal monopoly; establish postage rates; determine and impose compensation rates for bargaining unit employees, and review and act on complaints. *These recommendations would empower an appointed board with the unprecedented authority to dismantle the fundamental elements of postal services without further Congressional review.*

- Rescind existing regulations that require citizen input before closing plants and small post office. *Rural and urban post offices deemed unprofitable would be closed, and future services would be provided on an ability-to-pay model.*

- Permit outsourcing contracts and worksharing discounts that exceed the costs the Postal Service avoids when the work is performed "in house." *There can be no justification for discounting postage rates beyond the postal costs avoided. Despite the recommendation to limit any new worksharing discounts to costs avoided, the Commission recommendations would permit the continuation of existing worksharing discounts that exceed the postal costs avoided.*

- Impose severe limitations on the right of employees to engage in collective bargaining; undermine job security, and remove postal employees from federal status for retirement, health benefits, and workers' compensation.

  (Despite the public representation by Co-Chairman James A. Johnson that the recommendations regarding wages would not affect current employees, the Commission concluded that "if the Postal Regulatory Board determines that a total compensation premium exists for current employees, it should be authorized to determine the appropriate period of time during which the premium must be eliminated, and to review periodically its initial determination and the Postal Service's progress in eliminating the premium.")

Recommendations that would strip postal workers of free collective bargaining are unacceptable to the American Postal Workers Union, and we believe their adoption would be a disservice to the American public.

Specific Recommendations by the Commission the APWU Could Support

We recognize that many believe the decline in first-class mail volume over the past two years will continue indefinitely due to electronic communications and electronic fund transfers. Yet not a single recommendation of the Commission proposes to reverse this trend.

I have maintained that the nation's economic slump has been equally responsible for the declining mail volume. Historically, in a growing economy, mail volume increases have offset the effects of technological change. Over the past 100 years, hard-copy communications have been affected by the use of the telephone, facsimile machines, and now a variety of electronic communications. During each of these periods of change, a growing economy has generated an increase in mail volume.

I predict that as the economy recovers, mail volume will grow again, despite electronic communications and transfers. The dominant means of communication in the future has not yet been determined. Resistance to telemarketing and tighter state and national bans on unsolicited marketing via the internet are likely to mean that mail dedicated to advertising will at least hold its own. The fact that 42 percent of American citizens do not yet use personal computers for *any* communication, coupled with continuing resistance to paying and receiving bills electronically means that first-class mail will continue to be used heavily for these services as well.

We recognize, nevertheless, that prudence requires that some reasonable actions be taken now to preserve and protect the Postal Service from the impact of continuing change. To that end, the APWU would support a number of positive changes. These include:

- Expanding the services provided by the Postal Service beyond its traditional boundaries (recognizing that such expansion may not be subsidized by postal monopoly revenues);
- Improving flexibility in setting rates;
- Shortening the time for rate-setting;

- Providing regular rate increases, with advance notice, to enable mailers to better budget their costs;

- Permitting more appropriate salary levels for postal officials;

- Strengthening the Board of Governors and holding the management structure accountable for their decisions;

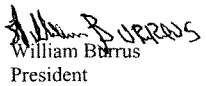
- Reviewing and modifying the allocation of institutional costs among different classes of mail; and

- Transferring military-service retirement costs to the Department of the Treasury as they are for all other federal agencies. *None of the recommendations proposed by the Commission could match the savings that would be achieved by this change alone, and no attempt at postal reform can be considered serious if it fails to relieve the Postal Service of this $27 billion liability.*

These changes would represent positive steps to protect the future of the Postal Service. If they are enacted, the Postal Service could continue to provide service for the American public as it has throughout its history.

We again thank you for the opportunity to offer these summary remarks to the Committee concerning the Report of the President's Commission. If you decide to consider legislation that would affect the Postal Service, we are available to work with the Committee in the interests of the Service and the American public.

Sincerely,



William Burrus
President

WB/lbb
opeiu#2, afl-cio

Association of American Publishers, Inc.
www.publishers.org

50 F Street, N.W., 4th Floor
Washington, D.C. 20001
Telephone: (202) 347-3375
Fax: (202) 347-3690

Patricia S. Schroeder
President and
Chief Executive Officer

November 13, 2003

The Honorable Susan M. Collins
Chair
Senate Committee on Governmental Affairs
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Madam Chair:

On behalf of the Association of American Publishers ("AAP"), I submit these comments to the Senate Committee on Governmental Affairs and request that they be made a part of the record of the Committee's November 5, 2003 hearing on the report of the President's Commission on the United States Postal Service (the "Commission").[1]

AAP is the national trade association of the book publishing industry in the United States. Its membership of over 300 companies and other organizations includes most of the major commercial book publishers in the U.S. as well as smaller and non-profit publishers, university presses, and scholarly societies. AAP members publish hardcover and paperback books and journals in every field of human interest, including textbooks and other instructional materials for the elementary, secondary, and postsecondary educational markets; reference works; and scientific, technical, medical, professional and scholarly books and journals. They also publish e-books and computer programs, and produce a variety of other multimedia products and services.

AAP members make particular use of the Bound Printed Matter subclass to send books through the mail, and also use the Periodicals class to mail scientific and scholarly journals and other educational materials. AAP has been an active participant in postal policy matters and in the postal ratemaking process, including nearly every rate proceeding before the Postal Rate Commission ("PRC") in the past twenty years.

[1] *Embracing the Future: Making the Touch Choices to Preserve Universal Mail Service*, (hereafter, "Commission's Report") (July, 2003) at xi.

For years, one of the most cost-effective means of delivering a book to anyone anywhere in the United States has been through the U.S. mail. While other private package delivery services can and do deliver books, such services are generally more expensive than mail and do not provide delivery to every address in the nation. AAP is concerned that, if the financial picture for the U.S. Postal Service continues to worsen, the costs of delivering books and other content-based mail will increase to such an extent as to make the delivery of such materials through the mail uneconomical. Even more troubling is the prospect that the Postal Service will no longer be required or able to provide universal service, a change that could hamper the ability of publishers to widely disseminate educational and other literary materials through the mail, particularly in those states that have largely rural populations.

Consistent with the national educational goals of promoting literacy and encouraging reading, there is a national interest in the broad dissemination of books and journals through the mail at economical rates. Throughout the years, Congress has undertaken numerous initiatives aimed at improving literacy and encouraging reading. In 1999, Congress enacted the Reading Excellence Act that authorizes appropriations of some $260 million annually to improve children's reading. In 2000, it enacted the Literacy Involves Family Together Act that reauthorized and increased funding for the Even Start literacy programs. And, of course, the No Child Left Behind Act of 2002, which enacted the President's education proposals, provides for additional funding mechanisms to promote literacy among children. Literacy measures have also been part of legislation such as the Workforce Investment Act, the Head Start Improvement Act, and the National Literacy Act, among others.

Thus, the decisions that Congress makes regarding the mission of the Postal Service must be viewed in the context of the public interest in ensuring that people have convenient and affordable access to reading materials anywhere in this country. With these considerations in mind, AAP offers the following comments on particular aspects of the Commission's report.

1. AAP Supports the Continuation of Universal Service

Fundamentally, AAP believes that the Postal Service needs to adhere to its primary mission of providing universal service at affordable rates for all classes of mail. For AAP and its members, this allows books and journals to be delivered to people across the nation – regardless of socioeconomic status or geographic location – at reasonable costs. Accordingly, AAP strongly supports the Commission's recommendation that the Postal Service continue to focus on its "core value" of universal service and delivery of letters, publications, and parcels. In a similar

vein, AAP fully supports the Commission's recommendation that the Postal Service should not be privatized. AAP is concerned that privatization could lead the Postal Service to eliminate Congressionally-mandated rate preferences for certain subclasses, and likely would result in the consolidation or elimination of various subclasses of mail. Privatization could also lead to the elimination of universal service, with troubling consequences especially for rural jurisdictions whose citizens depend upon assurances of continued full Postal Service coverage to address many of their critical communication and delivery needs.

2. AAP Supports Change to the Ratemaking Process

AAP believes that there are significant deficiencies in the current process insofar as it favors the *status quo* and discourages innovation. The current ratemaking process places the burden upon the intervenors to present information to disprove the Postal Service's case. Although the Postal Service must file a case-in-chief that contains information regarding its finances and costing methodologies, as well as specific descriptions outlining the bases for its proposed rate increases in each class and subclass, the material supplied by the Postal Service is often incomplete or fails to fully explain the basis for its proposals. Even if a party convinces the Postal Rate Commission (PRC) that the Postal Service's proposal is flawed, and the PRC recommends rates different from those proposed by the Postal Service, the Postal Service Board of Governors – through a unanimous vote – can still implement the rate increases it proposed at the start of the rate case if it finds that the rates recommended by the PRC are not adequate to provide sufficient total revenues.[2]

Notwithstanding these basic concerns, AAP questions whether implementing the Commission's recommendations regarding the ratemaking process would actually lead to the relief long sought by mailers. While the proposed price-cap mechanism has the potential to provide greater regularity and predictability in rate increases, there is little practical ability for anyone to affect or challenge those increases once they have been implemented by the Postal Service. A process that is essentially predicated upon the filing of a complaint after the rate increase is adopted is unlikely to afford a meaningful opportunity to question the validity of a rate increase. From a practical standpoint, it would be difficult to roll back rates or provide refunds to customers if the proposed new Postal Regulatory Board were to determine that the rates were too high.

[2] 39 U.S.C. § 3625(d).

Nonetheless, AAP supports implementation of a streamlined ratemaking process, particularly one that is primarily based on written submissions. Such a process will permit a wider range of mailers to have input into the ratemaking process. Ultimately, the success of the Commission's proposal depends on the willingness and ability of the Postal Service to ensure complete transparency of the costs for different classes of mail. The burden must be on the Postal Service to demonstrate that rate increases are justified.

AAP strongly urges that a critical public interest policy set in place by Congress in 1970, requiring the Postal Service and the PRC to take into account the "educational, cultural, scientific, and informational value to the recipient of the mail matter" (commonly referred to as "ECSI consideration") when considering rate increases, should be statutorily-maintained. AAP believes that Congress should ensure that modifications to the ratemaking process would not have the unintended effect of producing higher rates for mail that traditionally has been accorded ECSI value. Accordingly, AAP believes that ECSI consideration should continue to be taken into account any time rate increases are proposed for content-based mail such as books, magazines and journals.

3. AAP Supports Increased Worksharing Measures

One means by which the Postal Service might begin to reduce its costs is to place greater emphasis on worksharing. Publishers, like other mailers, are willing to work with the Postal Service to devise worksharing methods that shift certain Postal Service costs directly to the mailers. Many have the ability to prepare and sort mail to a level that permits the mail to be entered further along in the mail-stream, thereby reducing the Postal Service's mail processing and transportation costs.

Accordingly, AAP generally supports the Commission's recommendations urging the increased availability of worksharing opportunities, as well as its recommendations regarding the use of Negotiated Service Agreements ("NSAs"). AAP strongly agrees with the Commission's recommendation that the Postal Service should work closely with smaller mailers to develop more ways for them to participate in such arrangements. In particular, worksharing measures and NSAs must be designed to be available and effective for mailers with small volumes. Finally, the Postal Service should be encouraged to affirmatively respond to suggestions from mailers regarding possible ways in which their mail preparation activities could reduce Postal Service costs.

4. AAP Urges Congress to Examine Labor Cost Issues

AAP agrees with the Commission's conclusion that significant effort must be made to reduce labor costs. As the recent issues surrounding passage of the Postal Civil Service Retirement System Funding Reform Act of 2003 have shown, controlling these costs can result in dramatic cost savings to the Postal Service – savings that can be passed on to its customers in the form of smaller and less frequent rate increases. AAP recognizes that many of the Commission's proposals in this area are controversial, but believes that they should serve as a starting point for a full and open discussion with interested parties, including the postal unions, regarding constructive ways in which all postal stakeholders can work together to ensure that the Postal Service remains financially viable.

Conclusion

On behalf of AAP and its members, Senator Collins, I want to thank you for the vigorous and timely leadership you have provided on postal issues over the past two years. Your advocacy for the establishment of a Presidential Postal Commission proved foresighted in light of the important work that has been performed by just such a body this year. Your determination, together with that of Senator Tom Carper, in introducing and securing speedy enactment of the Postal Civil Service Retirement System Funding Reform Act of 2003, was pivotal in correcting a dangerous flaw in that system and buying much-needed additional time to more fully address the overall fiscal crisis that has engulfed the Postal Service. We greatly appreciate your actions in convening these hearings and committing to work with Senator Carper and other interested members to produce bipartisan postal reform legislation in the current Congress. We have no doubt that, in representing a largely rural state, you fully understand what is at stake in the struggle to preserve a postal system that can deliver efficient and affordable universal service.

Postal reform remains an exceptionally difficult but essential task. AAP believes the Commission's report provides a good framework for advancing the process of postal reform, and that implementation of the Commission's recommendations as discussed will generally serve to improve and maintain a postal system that "binds the nation together." AAP looks forward to working with the Committee and its Chair as they consider the Commission's recommendations and develop the next steps toward achieving meaningful postal reform.

Sincerely,

Patricia Schroeder
President and Chief Executive Officer

STATEMENT ON POSTAL REFORM OF THE ASSOCIATION FOR POSTAL COMMERCE

EXECUTIVE SUMMARY

I. Although many of the President's key legislative recommendations can be adopted intact, conversion of certain recommendations into legislation will require refinement and clarification and, in some cases, modifications. Specifically:

❖ Congress must set clear criteria for defining how the new Postal Regulatory Board is to set and adjust rates under the price cap mechanism. The criteria must, at a minimum, mandate that rates be based on the costs of resources consumed through services provided at various points of network access varying from final delivery to initial collection and acceptance. Thus, rates should be unbundled, and predicated on correct, marginal cost pricing principles, subject to a cost floor for each rate subclass such that rates can not be established below variable costs.

❖ Similarly, Congress must set clear, but not overly prescriptive, criteria for the establishment and adjustment of rate ceilings and for the measurement and implementation of productivity savings. Legislation must also define the standard by which the regulator determines what types of mail are to be treated as non-competitive, must recognize unique and special values of certain types of mail, and make clear that, with the exception of these defined categories, the non-cost factors of current law are to have no further force and effect. The procedures by which the Postal Regulatory Board is to review rates must also be clarified to assure that the system is not only efficient but fair.

❖ Legislation must also address classification and service standards. It must include criteria for determining when the regulatory body, on complaint, may intercede when the Postal Service establishes regulations governing worksharing incentives that are arbitrary or discriminatory and for determining the type of sanctions the Postal Regulatory Board is empowered to impose if the Postal Service fails or refuses to meet reasonable and rational delivery standards, or seeks to control private sector initiatives with unnecessary and excessive rate regulation. The law must establish procedures pursuant to which the new regulatory body will review the introduction of new products and services, as well as changes to existing products and services.

❖ The President's Commission's proposal to confer upon the Postal Regulatory Board the authority to change two of the essential conditions of the Postal Service's mission requires modification. The definition of Universal Service and the scope of the monopoly involve matters of public policy and should, therefore, rest exclusively with Congress. The Postal Regulatory Board should submit to Congress periodic reports of its findings and recommendations concerning the scope of the monopoly and the universal service obligation so that Congress may, as circumstances warrant, appropriately modify the legislation.

❖ All decisions made by the Postal Regulatory Board should be subject to review by the Federal Circuit Courts of Appeal.

❖ The President's Commission's work force recommendations are an integral element of its comprehensive approach to postal modernization and deserve Congress' serious consideration.

II. Of the twenty recommendations made by the President's Commission that do not require legislative change, virtually all are derived from or grow out of the Postal Service's own Transformation Plan issued in April of 2001. Although some progress has indeed been made, the Postal Service's delivery on the promises it made in the Transformation Plan has not been as timely or as complete as it could be in three areas. Specifically:

❖ The Postal Service's response to the President's Commission's strong and resounding endorsement to broaden the scope of worksharing initiatives has, at best, been timid. The Postal Rate Commission's approach to this topic has equally contributed to the lack of progress in this area.

❖ Although the President's Commission characterizes the Postal Service's network rationalization initiative as the most "tangible and important deliverable," progress toward rationalization has been halting and indistinct, resulting in a continuation of the status quo under which mailers and their service providers are unable to realize the lowest combined public/private sector cost.

❖ The President's Commission stated that the Postal Service has both a legal and an ethical duty to be as transparent as possible in its financial and costing reporting. While there has been noticeable progress in this direction, further change must occur and it must occur quickly.

III. The President's Commission's recommendations to permanently resolve the Civil Service Retirement System Pension Overfunding issue and restore to the Treasury Department the obligation to pay the military portions of pension obligations that may be due to postal retirees are sound. Comprehensive reform of the pension system applicable to the Postal Service is an indispensable element of Postal Service transformation. Failure by Congress to act within the time limits established by Public Law 108-18 will have untoward, and potentially catastrophic, consequences for mailers and the Postal Service. This means that Congress must deal with the broader issues of postal reform, of which pension reform is undeniably a part, with the utmost expedition and dispatch, indeed, within the time limits for congressional action specified in Postal Civil Service Retirement System Funding Reform Act.

INTRODUCTION

PostCom's interest in the matter of reform of the Postal Service is long-standing and clear: the Association is comprised of large and small, commercial and not-for-profit businesses and organizations that use all classes of mail as a vital medium of communication with customers and prospective customers. Included among PostCom's membership are printing companies, consolidators, list managing organizations and other mail service providers upon whom these businesses and organizations depend to get their messages and products prepared and delivered to the Postal Service. Collectively, our members employ a very substantial percentage of the nine million U.S. jobs that are dependent on or related to the Postal Service and of the 9% of the gross domestic product that is represented by the mailing industry.

The President's Commission has done an outstanding job of analyzing the issues and threats confronting the Postal Service. The Commission's findings that the Postal Service is in grave jeopardy are undisputable. The Commission has set forth recommendations that are thoughtful and well calculated to enable the Postal Service to meet and overcome the financial, economic, and operational challenges that the Postal Service and the mailing industry now face. The task now is to convert the President's Commission recommendations into legislation, where legislation is required, and, where legislation is not required, into action.

PostCom submits that several of the key legislative recommendations passed by the President's Commission can be adopted intact. In particular, the proposed changes to the composition of the Board of Directors of the Postal Service and its role are clear, concrete and unassailably sound. Similarly, recommendations for incentive-based

compensation for Postal Service executives, and the removal of the break even cap are clear and complete and should be enacted as proposed.

However, conversion of others of the fifteen legislative proposals advanced by the President's Commission will require refinement and clarification and, in some cases, modifications. The Commission's recommendations concerning rate setting, service standards, universal service and access to the mailbox are, in particular, conceptual in character. While there is indisputably a need for flexibility in the legislation that will govern the Postal Service, PostCom strongly believes that these key recommendations must be fleshed out through statutory language. The legislation should preserve the President's Commission's goal of flexibility while providing clear policy guidance and parameters to the Postal Service, to its regulator and the mailing industry in order to assure that the ends the Commission seeks are fully realized. We address these issues in the first part of these comments.

The twenty recommendations advanced by the President's Commission that do not require legislation are of equal importance. Self transformation of the Postal Service is underway, but more can and should be done and the pace of change must increase. However, self transformation can and should proceed with dispatch, even while the legislative process is ongoing. In the second part of these comments, we identify areas of self transformation where we believe oversight by this Committee and the corresponding committee in the House of Representatives is required.

Last, but by no means least, PostCom submits that legislative reform and self transformation by the Postal Service are critically dependent on a permanent resolution of the pension overfunding issue identified in the Postal Civil Service Retirement Reform

Act of 2003, Public Law 108-18 and the related question of who should bear the cost of military pension veterans who are subsequently employed by the Postal Service. As we discuss in the third section of these comments, PostCom submits that the President's Commission's recommendations on these subjects are entirely correct. While it is certainly appropriate to deal with these pension funding reform issues in the context of broader postal reform, this means that Congress must achieve broader postal reform on an expedited basis -- indeed within the time for Congressional action embodied in Public Law 108-18.

I. Legislative Reform Requires Clear But Flexible Standards.

By any measure, the President's Commission's recommendations for transformation of the postal regulatory system are among the most important of the legislative changes it has advanced. The current Postal Rate Commission would be transformed into a new Postal Regulatory Board: it would be charged with protecting the public interest from monopoly abuse, establishing postal rate ceilings, considering alterations to the Postal Service's monopoly and the definition of universal service, and assuring financial transparency on the part of the Postal Service.

In his November 5, 2003 testimony before this Committee, the Postmaster General agreed with PostCom's long held view that reformation of the regulatory system is key to successful transformation of the Postal Service. What is lacking in the President's Commission Report and, for that matter, in the testimony of both Postmaster General Potter and the Comptroller General is the specific legislative changes that are required.

1. *Rate Setting.*

A central element of the new regulatory regime is the proposed change in the way rates are established. The Commission would move the ratesetting system from the too often ineffectual (and certainly outmoded) cost of service methodology that has been employed for the past thirty years to "incentive based" regulation in which the primary emphasis is placed on marketing and economic considerations, designed to encourage innovation and stimulate demand. The Commission concludes that a rate cap pricing regime for non-competitive products will allow the Postal Service greater pricing flexibility so long as overall rate increases are capped within an inflation/productivity adjustment range. PostCom agrees. However, while it is clear that the President's Commission's ratemaking system is conceptually based upon principles of ratemaking that have long and successfully been employed in other industries, the Commission's Report provides very little in the way of specifics, and no standards for the Regulatory Board to apply.

Congress must set clear criteria for defining how the costing system is to be revamped and how the new Postal Regulatory Board is to set and adjust rate ceilings. On the one hand, there is the danger of "hard-wiring" both the "baskets" and "rate bands" of the various products and services offered by the Postal Service, and the rate ceilings for these products and services, subject to change only through further legislation. Legislative "micromanagement" is as undesirable as micromanagement of the Postal Service by its governing board or, for that matter, by its regulator. On the other hand, granting the postal regulatory body complete, unfettered discretion to decide what sort of costing methodology to use to set and readjust ceilings, productivity factors and the like is equally dangerous. It permits, if it does not actively invite, a ratemaking mechanism which, like the current one,

is too heavily dependent on judgmental, and therefore subjective and unquantifiable notions of "fairness."

Therefore, PostCom believes that Congress must mandate objective ratemaking criteria: initial rates must be based on the costs of resources consumed through services provided at various points of network access varying from final delivery to initial collection and acceptance. Fully unbundled rates will require ratepayers to pay for the services they use, and will promote expansion and innovation in worksharing activities with the private sector by providing mailers with the accurate price signals they lack under the current regime.

Under the new regulatory regime, proper costing of postal services will continue to be an important task beyond the initial rate proceeding because, among other things, the President's Commission has correctly stipulated that rates must cover the costs of providing the service to protect against cross-subsidization. For these reasons, the postal regulatory body must be directed by Congress to review rates on the basis of measured and measurable cost causation. Rates should be predicated on correct marginal cost pricing principles, provided that rates for each subclass are established to recover costs which vary with the characteristics of the subclass.

Similar clear but not overly prescriptive criteria for the establishment and adjustment of rate ceilings and for the measurement and the implementation of the productivity factor are required. The selection of the indices to be used by the Postal Regulatory Board in the establishment of incentive based, bottom up rates must not be left to the agency's unfettered discretion. The regulatory agency should not be free to arbitrarily select CPI or "some other index" as the cap. A rate escalation factor that is too loose will not provide the Postal Service

with the incentive and authority to control costs. Conversely, one that is too tight will eliminate pricing flexibility, forcing the Postal Service to raise all rates to the ceiling or to seek increases above the ceiling. Congress must provide the regulatory agency with direction in the selection (and possible modification) of the escalator, and must also clarify how the Regulatory Board is to create and modify the "product baskets" and "rate bands" upon which incentive based rates have traditionally been applied. The three baskets suggested by the Commission for ratemaking purposes seem reasonable and sufficient to the task, but these baskets should not be locked in: both the Postal Service and the Regulatory Board will need to make adjustments as circumstances change over time.

The legislation must also define the standard by which the regulator determines what types of mail are services to be treated as non-competitive. It must instruct the postal regulatory body as to how unique and special values of certain types of mail (periodicals and books) are to be recognized in an incentive based regime. The legislation must also make absolutely clear that, with the exception of identified mail matter with educational, cultural and scientific or information values, the allocation of so-called institutional costs under so-called non-cost factors of current law are to have no further force and effect.

Finally, legislation must make it absolutely clear that neither the Postal Service nor the Regulatory Board is permitted to deviate from the price cap mechanism system envisioned by the Commission. In a word, there should be no escape hatch or "exigent circumstance" adjustments: the term is incapable of rational or precise definition; and the mere inclusion of an exigent circumstance opportunity in the legislation simply invites failure of the incentive based regime that the Commission has envisioned.

The Congress must also give some attention to the process that the regulatory body is to follow in carrying out its ratemaking duties. The Commission's recommendations calling for a simplification of that process are well taken. PostCom supports the proposal to allow the Postal Service to implement rate changes in most circumstances, subject only to after the fact review by the Regulatory Board to a complaint process. PostCom also supports expedited advance review proceedings for establishing rates for new products and services and adjusting the rate cap and inflation and productivity factors.

Ironically, the Commission has been somewhat overly prescriptive in its discussion of time limits within which the Postal Regulatory Board is to act in rate matters and the nature of the proceedings it is to conduct in reaching its ratesetting decision. PostCom certainly agrees with the Commission that the current ten month period and the practice – if not the legal requirement – of on-the-record, trial type hearings in all matters is unproductive. The practical consequence of the current system is to force parties affected by rate changes to either litigate to the bitter end or settle; and this Hobson's Choice does not serve the interest of mailers, of the regulator or, for that matter, the Postal Service. At the same time, the Commission's stipulation that the Postal Regulatory Board complete all reviews within sixty days and without any trial type hearings in all cases pushes matters to the opposite extreme. As other agencies employing incentive based rate regulation do, the Postal Regulatory Board should be empowered to suspend particular rate proposals or new rate or product offerings for a period of time and to conduct trial type hearings as special or unusual circumstances warrant. But the legislation must make absolutely clear that the power to suspend – which should be of a fixed duration of not more than four to five months – and the conduct of evidentiary hearings constitute the exception to the rule and not the rule as it is now.

2. *Classification and Service Standards.*

A somewhat different task of legislative drafting arises with respect to the President's Commission's recommendation that the Postal Regulatory Board be given much greater power than it has now over service and service standards. One of the key shortcomings of the current statute is its failure to provide any criteria for delineating the difference between managerial prerogatives, which quite properly belong with the Postal Service, and service and performance standards, which should fall within the purview of an independent and rigorous regulatory agency. In revamping the structure of both the Board of Directors, and in establishing the Regulatory Board as completely independent of the Board of Directors, the goal of the Report is quite clear. However, here, too, matters left unanswered in the Report must be addressed in the legislation. These include criteria for determining when the regulatory body, on complaint, may intercede if the Postal Service establishes regulations governing worksharing incentives that are arbitrary or discriminatory; and for determining the type of sanctions the Postal Regulatory Board is empowered to impose when the Postal Service fails or refuses to meet reasonable and rational delivery standards or seeks to "control" private sector initiatives with unnecessary and excessive regulation.

The President's Commission Report also properly recognizes that the introduction of new products and services is an important part of reform and transformation. It proposes a procedure under which the Postal Service would be empowered to implement new products and services on the basis of an expedited advance review process. The Report, however, is silent on the matter of classification changes to *existing* products and services that do not require either new or changed rates. It is clear that the President's

Commission did not contemplate that the existing classifications of non-competitive products be frozen for all time or be subject to change only through legislative action. Thus, PostCom believes that the legislation must spell out how changes to existing classifications are to be initiated and subjected to regulatory oversight. One possibility is to apply the same expedited advance review process to changes to existing classes and rate categories that the President's Commission contemplates for new products or services. Among other things, such an approach would eliminate the thorny problem – which has spawned litigation at other regulatory agencies – of whether a particular classification change is "new" or simply alters the terms and conditions applicable to a current subclass or category. This approach would not only simplify the rules, but it would serve to make it easier for the Postal Service to introduce innovations within the existing classification structure, and thereby further serve the President's Commission's goal of promoting flexibility in the Postal Service's core businesses.

3. Universal Service; Access to the Mail Box.

The President's Commission Report would confer on the Postal Regulatory Board authority to change two of the essential conditions of the Postal Service's mission as it stands today: the Regulatory Board would be permitted to redefine the scope of the Postal Service's universal service obligation and to alter the existing restrictions on access to the mail box by alternative service providers. The two go together since the restrictions on access to the mail box are generally viewed as an indispensable element of the ability of the Postal Service to carry out its universal service duties as they are defined today.

Both the Postmaster General and the Comptroller General have, in their testimony before this Committee, expressed reservations about the breadth, or scope, of the powers the President's Commission would confer on the Regulatory Board. The Comptroller General said specifically that "matters of public policy" should remain where they belong under the United States Constitution: with the Congress. We agree. The issues of universal service and the issue of access to the mailbox unmistakably involve matters of basic public policy that are best left to neither the Postal Service nor the Regulatory Board, but to Congress.

One of the core difficulties of the current statutory structure is that it vests the exclusive power of interpretation and enforcement of the Private Express Statues, including the mailbox statute, in the Postal Service. The Supreme Court has said that the Postal Service decisions on these subjects are unreviewable by courts. This is simply a re-affirmation of the principle that issues of universal service and monopoly are matters of public policy. However, because the Postal Service has unilateral and unreviewable control of these matters, the result has been a patchwork of exemptions and interpretations which make little or no sense in either operational or economic terms and which are largely the outcome of the Postal Service's grudging responses to political pressure. Nor has enforcement of these universal service and monopoly powers – which is also vested exclusively in the Postal Service – been consistent or evenhanded. Plainly, that has to change.

But no purpose would be served, and serious harm would ensue, if these pure public policy issues were simply transferred to an independent agency. It is a bedrock principle of the American system of administrative law that the task of independent

agencies is to neither make law nor define public policy. The task of administrative agencies is to see to it that the policies and laws established by the Congress and the President under the Constitution are implemented as intended and enforced in an even and fair manner.

These questions of the universal service obligation and of access to the mailbox, then, constitute an area in which, in our judgment, the President's Commission's recommendations require modification. It is plain that the current law must be changed to take the powers of implementation and interpretation away from the Postal Service. It is also plain that the existing cat's cradle of exceptions and exemptions need to be rationalized and modernized. To take but a single example, under current Postal Service rules, a catalog of twenty-three pages is subject to the monopoly, but a catalog of twenty-five pages is not. The distinction in formal terms is largely academic since the Postal Service has a *de facto* monopoly over most catalogs, regardless of the number of pages they contain.

PostCom submits, therefore, that these fundamental matters of definition of the scope of the monopoly of exceptions and exemptions and of access to the mailbox should be made by the Congress and should remain within the exclusive prerogative of the legislature. This does not mean, however, that the new Postal Regulatory Board has no role to play in this process. Because it is to be composed and staffed, under the President's Commission's vision, by people with business, economic and legal expertise, and because it will be closely monitoring the affairs of the Postal Service, of mailers and mail service providers, and of postal alternative service providers on a regular, continuing basis, it is in a position to assist the Congress in carrying out the Congressional oversight

of these basic public policy issues. Thus, legislation should require the Postal Regulatory Board to conduct periodic reviews of the economic, social and policy considerations which underlie the scope of the universal service obligation and the scope of the monopoly and should be mandated to submit reports to Congress, based on the views and submissions of all interested parties, of its findings and recommendations. Periodic reporting will not only enable the Congress to more effectively and efficiently carry out its public policy responsibilities, but will also serve to assure that these policies are susceptible to rational and orderly change as changes in economic and other conditions may warrant.

4. Judicial Review.

The President's Commission report does not address the question of whether there is or should be judicial review of any of the matters which are placed within the jurisdiction of the Postal Regulatory Board. We believe this to be simply an inadvertent omission. At all events, it is an oversight which must be rectified if the legislative reforms that the President's Commission has proposed are to work. PostCom believes that all decisions made by the Postal Regulatory Board should be subject to review by the Federal Circuit Courts of Appeal.

Judicial review of Postal Regulatory Board decisions is important not merely because it serves as a check against arbitrary, capricious or otherwise unlawful actions by the regulatory agency. Judicial review in this context serves certain intensely practical considerations, forcing both the Postal Service and the regulatory body to consider the consequences of their actions before they are taken. The imposition of a system of appellate judicial review – common to virtually all utility commissions -- serves also to

strengthen the distinction between the duties and limitations on the Postal Regulatory Board and the duties and powers of the Postal Service's Board of Directors. In our view, judicial review should be applicable only to decisions and actions of the Regulatory Board.

5. Workforce Recommendations.

Although not without controversy, the President's Commission's workforce recommendations are an integral element of its comprehensive approach to postal modernization. Some of the specific recommendations the President's Commission has made may be problematic. For example, conferring upon the Postal Regulatory Board the power to involve itself directly in the management oversight process simply adds another layer to what is already a complicated and difficult process. On the other hand, a number of the Commission's recommendations in this area deserve Congress' serious consideration. With the ominous reality of stagnant or declining mail volumes due to marketplace changes and inroads from competitive alternatives, attention to the procedures through which collective bargaining is carried out and the standards that are used in resolving labor/management disputes deserve close and thoughtful scrutiny by the Congress.

II. Self Transformation Requires Action

Of the twenty recommendations made by the President's Commission that do not require legislative change, virtually all are derived from or grow out of the Postal Service's own Transformation Plan issued in April of 2001. It is manifest that the President's Commission thought highly of the hard work that Postal Service management

put into the development of that plan and of the collaborative effort between the mailing industry and the Postal Service in the development of its precursor, the Mailing Industry Task Force Report. We agree. The Postal Service's self transformation efforts could, without legislation, go a long way to rejuvenate the Postal Service and bring it closer to the Presidential Commission's ultimate goal of the "most capable and efficient Postal Service that modern techniques and 'best execution' strategies can make possible." PostCom further believes that the very process of self transformation, as outlined by the President's Commission, would bring both direction and focus to those issues which do require legislative change.

Unfortunately, although some progress has indeed been made, the Postal Service's delivery on the promises it made in the Transformation Plan and embraced by the President's Commission has not been as timely or as complete as we might expect. In particular, there are three areas of self transformation in which the Postal Service has either not moved at all or has moved so slowly as to raise questions about the depth of the Postal Service's commitment to self transformation. We urge the Committee to press the Postal Service closely on these subjects which, we believe, are inextricably intertwined with the need for and direction of legislative reform.

1. Expansion of Worksharing Initiatives.

The President's Commission strongly and resoundingly endorsed the Postal Service's ambition to broaden the scope of worksharing initiatives to refine and customize service offerings -- Negotiated Service Agreements, and Niche Classifications. The President's Commission also cautioned against excessive "timidity." While the Postal Service has, in fact, launched several expanded niche worksharing arrangements,

its progress in this area may be fairly called "timid." The Postal Service's progress on the Negotiated Service Agreement ("NSA's") is even more disappointing. The subject of NSAs has been analyzed, discussed, and explored for over a decade. Yet, there has been only one NSA proposed to the Rate Commission. While the Postal Service informally insists that there are a large number of other NSAs "in progress," there has been no indication of whether these will come to fruition or when they will do so.

The Postal Service's failure to vigorously pursue these innovative customized service agreements is not entirely its own fault. Although the Rate Commission repeatedly insists that it is receptive to NSAs, at least in principle -- and indeed it did approve the one NSA submitted to it -- the President's Commission's concern about excessive "timidity" applies as much to the Rate Commission as it does to the Postal Service itself. Instead of dealing with NSAs on a case-by-case basis as they are submitted until a body of experience has been developed, the Rate Commission has initiated a rulemaking to establish detailed procedural and in some respects substantive rules to govern this form of rate arrangement on the strength of its experience with the only NSA it has seen. As a result, resources that might be committed by both the Postal Service and the Rate Commission to the actual consideration of real arrangements are instead being diverted to what threatens to be a unproductive exercise attempting to define the nature, contents and procedures of NSAs on the basis of virtually no experience.

2. Rationalizing the Network.

The President's Commission characterized the Postal Service's network rationalization initiative as the "most tangible and important deliverable" of the

Transformation Plan. To its credit, the Postal Service has invested considerable energy and resource into a network design model that should enable it to maximize the efficiency of its back-end distribution systems – the bulk mail centers and similar processing facilities. What has not happened to date, however, is the realization of any clear and tangible change in the way the network is configured or in standardizing the ways in which mail is processed in various facilities that comprise the network. What has happened instead is a protracted, halting movement toward redefining mail categories and processing standards that are, too often, focused entirely on the Postal Service's view of its current network and too rarely attend to the marketing and business imperatives of mailers.

The result is a continuation of the status quo in which mailers or mail service providers and logistics companies are unable to fully utilize their own capabilities to prepare, sort and enter the mail in ways which would realize the lowest combined costs. The President's Commission ultimately contemplates that realignment would be reviewed by a network optimization commission. In his testimony before this Committee, the Postmaster General has stated that the Postal Service sees no need for such a Commission. Neither does PostCom. Realignment of the network, therefore, need not wait for legislation.

3. Financial Transparency.

The President's Commission stated that the Postal Service has both a legal and ethical duty to be as transparent as possible in its financial reporting. It "strongly" recommended that the Postal Service voluntarily comply with the principal Securities and Exchange Commission reporting requirements applicable to publicly traded companies.

The Postal Service is moving in the right direction in this area, but there is more that can and should be done. The quarterly financial reports and the financial and operating statements the Postal Service now prepares are certainly better than earlier versions of these documents. We are particularly gratified by the Postmaster General's statement to the Committee that the Postal Service does intend to accept the President's Commission's recommendation that it voluntarily adhere to the reporting requirements established by the Securities and Exchange Commission. PostCom hopes that this further change will occur quickly and that it will lead to greater clarity and rigor in the preparation of the accounting period and quarterly reports that the Postal Service now issues.

PostCom also hopes that the Postal Service will not merely accept, but will embrace the changes that the Postal Rate Commission has recently made to its periodic reporting requirements. Not the least of the difficulties with the current ratemaking system is that much of the costing and revenue information that the Postal Service compiles is not submitted or made public until the filing of a general rate case. The cost and delay that the regulator and affected parties incur in attempting to analyze this periodic flood of data contributes not only to the length of time these cases take, but to the resultant unsatisfactory or unclear outcomes. While transformation of the regulatory regime to a price cap system will change the way costing data is used and reviewed, there will remain a need for current, ongoing and accurate cost, as well as financial, data. The Commission's new rule thus compliments the Postal Service's voluntary acceptance of SEC reporting obligations in promoting greater financial transparency.

There are those who may say that this issue of financial transparency, particularly as it relates to SEC reporting requirements, is simply window dressing: the SEC

reporting requirements are designed to inform stockholders, and the Postal Service has no stockholders. However, the Postal Service most certainly has stakeholders, including, most especially, mailers and the vendors who support and make possible their use of the postal system. These stakeholders and others critically need access to meaningful, rigorous financial and cost data in order to formulate their own business plans and to determine – rather than guess – how best to interact with the Postal Service and use Postal Service products in order to achieve the lowest combined public/private cost. Legislators and regulators also require this information to periodically review the efficacy of the new regulatory regime.

We believe it entirely appropriate for this Committee, in its oversight capacity, to require that senior management of the Postal Service periodically report to the Committee and the public regarding their progress with respect to non-legislative initiatives and what the expected timelines are for delivery on the promises it has made with respect to these matters in its own Transformation Report. The Committee should require GAO to review these reports and related Postal Service performance, financial and operating data, and evaluate the progress of the Postal Service in achieving its transformation goals. In a word, we need metrics to measure Postal Service progress.

III. Prompt Reform of Postal Service Pension Funding

The President's Commission recommendations to permanently resolve the Civil Service retirement system pension overfunding identified and temporarily remedied by Public Law 108-18 and to restore to the Treasury Department, rather than the Postal Service, the obligation to pay the military portions of pension obligations due to Postal

Service retirees who have served in the Armed Services are essential to both the long and short term viability of the postal system. The discussion of how the "savings" realized by the Postal Service as the result of the enactment of Public Law 108-18 has begun in accordance with the schedule set forth in that statute. But there is a great danger that this debate will lose sight of who created the surplus, including the surplus that will be placed in the escrow account in the first instance. The simple fact is that mailers paid more – in the order of $3 billion per year more – through their postage rates than a properly specified formula would have required. Thus, it is, in some sense, misleading to speak of "savings" accruing to the Postal Service. These are "savings" that should accrue to the mailers who created the surplus in the first instance. The exact same consideration applies to the question of the military portion of the pension. These costs should be paid by the Treasury because the obligations accrued during the individual's service to the military, not the postal service. These are costs that should be borne by taxpayers and not by postal ratepayers.

Reform of the retirement system applicable to the Postal Service is thus an indispensable element of Postal Service transformation. However, action must be taken immediately. Failure by Congress to act within the time constraints established for Congressional action under Public Law 108-18 will have serious adverse consequences to the whole process of transformation. At the very least, resumption of payments to Treasury beginning in FY 2006 will require an earlier and larger rate increase than is otherwise necessary, according to the Postal Service itself. Moreover, if experience is any guide, the entire process of self transformation will come to a halt while the Postal Service and mailers focus their attention and limited resources on the rate case.

These consequences can and must be avoided. What that requires, however, is that Congress deal with the broader issues of postal reform, of which the pension reform is undeniably a part, with the utmost expedition and dispatch. Any appreciable delay in relieving the Postal Service and mailers from the unwarranted burden of pension overfunding will only exacerbate the threats and challenges that the Postal Service now faces and will dilute the potential benefits of postal reform.

CONCLUSION

PostCom believes that the vision of the future of the Postal Service, as articulated in the President's Commission's Report, is one that all Americans can embrace. Through these hearings, we are convinced that the task of converting those recommendations to reality can be accomplished on an expedited basis. We applaud and encourage the Committee for its constancy and willingness to deal with these difficult and sometimes contentious issues. PostCom stands ready to assist the Congress in whatever ways the Committee deems appropriate to make the Postal Service, through legislation and self transformation, what it can and should become.

DC2:\499692

U.S. Senate
Committee on Governmental Affairs

Testimony of
William J. Olson, Legal Counsel
Association of Priority Mail Users, Inc.

on the
Recommendations of the
President's Commission on the U.S. Postal Service

November 19, 2003

Association of Priority Mail Users, Inc.
Lyle Ryter, Director of Government Relations
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
703-356-6913
www.apmu.org; email: contact@apmu.org

Introduction

The Association of Priority Mail Users, Inc. ("APMU"), which was founded in 1993, is a nationwide coalition of businesses which are substantial users of Priority Mail and other firms interested in the success of this postal product. APMU works with the U.S. Postal Service, litigates before the Postal Rate Commission, and advocates before Congress in support of fair, reasonable, and stable rates, as well as reliable service for Priority Mail. Additional information is available at www.apmu.org.

APMU recognizes the Recommendations of the President's Commission on the U.S. Postal Service as a watershed event for the American people and mailer industry. With an annual expansion of delivery points and customers and a gradual reduction in its work force, we believe that maintaining the "universal service" mandate will challenge the ingenuity and management skills of Postal Service management as well as that of Congress in its efforts in support of continuing a self-supporting postal system.

APMU wishes to address three issues for the benefit of the members of the Senate Committee on Governmental Affairs. The first two issues present weaknesses in the current system — one statutory and one cultural. Discussion of the last issue sets forth reasons for optimism based on the current leadership of the Postal Service.

The Governors' Unilateral Power to Increase Postal Service Rates

The Postal Reorganization Act of 1971 ("the Act") defines the process for the setting of domestic postal rates and fees. The Act divides authority over postal rates between the Postal Service and the Postal Rate Commission. The Act guarantees substantial due process and other protections of mailers' rights in the ratemaking process. However, nearly all such protections

apply only to the process whereby the Postal Rate Commission develops "recommended" rates. While such recommended rates are normally accepted and implemented by the Governors of the Postal Service, there is a mechanism whereby the Governors can bypass such due process rights and impose rates unilaterally — which we have called the "anarchy clause."

Postal rates normally are set in an "omnibus rate case," which begins when the Postal Service files a request for a recommended decision on postal rates and fees with the Postal Rate Commission. The Commission then offers mailers and other interested parties the opportunity to question the Postal Service witnesses in writing and orally regarding the Postal Service's proposed rates, to present alternative rates, and to argue against the rates proposed by the Postal Service and other parties. Mailers may put forth their evidence, and be challenged on it by the Postal Service and by other mailers. Also, there is an opportunity for reply testimony. The cases end with two rounds of briefs, and, sometimes, oral argument.

The Postal Rate Commission, by statute, has 10 months to conduct the case, which means from the time of receiving the Postal Service's request the Commission must develop a schedule to allow time for written questioning of the Postal Service and other parties, holding all of the public hearings, examining the evidence, reviewing initial and reply briefs filed by the parties, selecting "recommended" rates for each "rate cell" and "rate component," and issuing an Opinion and Recommended Decision to the Board of Governors.

The rate changes are only "recommended" by the Postal Rate Commission, and are not implemented until they are approved by the Board of Governors. If the rates are not approved, the Board of Governors can reject the Commission's recommended rates, allow the rates to be implemented "under protest," or request reconsideration by the Commission.

If reconsideration by the Postal Rate Commission is requested, and the Commission does not yield to the position of the Postal Service, the Governors may modify rates if they unanimously, in writing, concur in the view that modification of the rates "is in accord with" the record of the Commission's proceedings and the Postal Reorganization Act, and that the Commission's recommended rates will not provide sufficient revenues.

The Governors have exercised this so-called "anarchy clause" to modify rates – *i.e.*, implement rates proposed by the Postal Service, notwithstanding the proceedings before the Commission — on three occasions: Docket No. MC78-2 (a mail classification case affecting advertising mail); Docket No. R80-1 (an omnibus rate case); and Docket No. R2000-1 (which implemented a July 2001 rate increase related to the 2000 omnibus rate case).

Although part of the Postal Reorganization Act, this "anarchy clause" actually conflicts with fundamental principles underlying the Act. The 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 from the Postal Rate Commission of control over rates . Nevertheless, the courts have imposed very few limits on the Governors' power to exercise the anarchy clause, although they have held that mailers' due process rights are sharply circumscribed when the Governors take such unilateral action. The absolute limits of that power have not been firmly established, but many believe that the practical difficulties involved in challenging its exercise have allowed the Governors excessive power which is inconsistent with the fundamental ratemaking procedure established in the Act.

Mailers remain at the mercy of the Governors' ability to set postal rates virtually however they want using the anarchy clause, even where those rates contradict the evidentiary findings of

the Postal Rate Commission. In 2001, the Governors exercised their powers under this clause and raised postal rates, including Priority Mail, despite the considered opinion of the Postal Rate Commission to the contrary. Priority Mail rates were, in effect, unilaterally imposed by the Governors, giving Priority Mail users two rate increases within six months. These rate increases have produced annual double-digit percentage decreases in Priority Mail volume since then.

As a result of the July 2001 increase in Priority Mail rates implemented by the Governors under the anarchy clause, many mailers felt totally vulnerable to increases in rates, even when the Postal Rate Commission did not recommend them. Since that time, many Priority Mail users have stopped considering the Postal Service a predictable vendor, as the Postal Service demonstrated its ability and willingness to impose, unilaterally, huge rate increases on mailers.

We recommend that the Governors' power to modify be repealed by Congress so that a government monopoly does not have the ability to set its own rates.

The Postal Service Has Refused to Consider Salutary Priority Mail Classification Changes Proposed by Mailers

The Postal Service has developed a reputation for rejecting mailer proposals regarding new products which were "not invented here" (*i.e.*, at the Postal Service). Although there appears to have been some improvement in this culture at the Postal Service in recent months, the problem has not been entirely fixed.

Priority Mail offers an example of the problem. For at least seven years, the Association of Priority Mail Users has urged the Postal Service to create a discounted rate for Priority Mail when it is used to drop-ship other postal products. This "Priority Mail Dropship," sometimes called "Open and Distribute," is generally used to expedite the transportation of sacks of mail to

a destinating Sectional Center Facility where the mail is opened and entered into the mail stream as, for example, Standard Mail. As this Priority Mail destinates at a Postal Service facility, it is never delivered to a business or a household, and the Postal Service incurs no cost in delivering this mail. Nevertheless, the Postal Service charges the same rate for this mail as it does for Priority Mail which is actually delivered to a business or household.

In Docket No. R2000-1, APMU used the right that it has under the Postal Reorganization Act to propose mail classification changes to the Postal Rate Commission. APMU presented a comprehensive proposal through the expert testimony of a veteran postal economist to the Postal Rate Commission for the creation of such a "new product." The Postal Service opposed this proposal by APMU, and did not cooperate in obtaining the data that it would have obtained if the proposal had been its own. The Postal Rate Commission declined to force the proposal upon the Postal Service, despite the fact that it generally viewed the proposal favorably:

> Witness Haldi [for the Association of Priority Mail Users] has identified a segment of Priority Mail volume that may merit recognition in the form of a rate category to which discounts would apply. In qualitative terms, the "Priority Mail dropship" segment already identified in the DMM would appear to offer the potential for such recognition. However, as the Postal Service has argued, significant uncertainties remain addressed, primarily for lack of cost and demand data specific to this portion of Priority Mail volumes. While the Commission commends witness Haldi for focusing attention on this type of Priority Mail, his discount proposal lacks sufficient support to warrant recommendation at this time. However the Commission strongly encourages the Postal Service to investigate the bases of such a discount in its ongoing review of the Priority Mail Subclass. [*Opinion and Recommended Decision*, Docket No. R2000, para 5338 (November 13, 2000).]

Even if the Postal Rate Commission had recommended the adoption of this APMU proposal, it would have been to no avail, for the Governors are not required to adopt any mail

classification changes that the Postal Service did not initiate. The Governors can adopt and implement the Opinion and Recommended Decision of the Postal Rate Commission which generally involves obtaining higher rates, but can sever the mail classification changes recommended by the Commission. In the final analysis, the authority of the Postal Rate Commission to decide on the merits of mail classification matters can be trumped by the power of the Governors.

Improvements Under the Current Postmaster General and Chief Operating Officer

On the other hand, there is good news. APMU was particularly pleased when, in early 2002, Postmaster General John Potter began several programs demonstrating his desire to improve Postal Service management.

With its Transformation Plan, the Postal Service has taken a new course in aggressively seeking out the means to modify existing practices and policies even without the enactment of postal reform legislation. Acting on that plan, Chief Operating Officer Patrick Donahoe has shown remarkable managerial skill in his successful efforts to reduce work hours and cut excess costs out of the system.

On May 28 and June 27, 2002, the Postal Service and Postal Rate Commission held two sessions to air criticisms of the process of omnibus rate cases and to engage in discussions of suggestions for changing the process to reflect the needs of the users. Together, these two **Postal Rate Summits** allowed for a comprehensive examination of rate and classification areas that could be changed by the Postal Service, within the framework of existing law, including niche classifications, negotiated service agreements, phased rate increases, etc. APMU was

particularly pleased by the participation of Postal Service policy-makers at the highest levels, including the Postmaster General. The brief time that separated the two meetings and the atmosphere of openness engendered by the speedy turnaround in responding to the concerns aired in the initial meeting gave APMU hope that a similarly-structured meeting might be possible to examine and structure Postal Service handling of Priority Mail pricing costs and service issues.

Thereafter, in response to the APMU request for discussions of the need to improve Priority Mail as a product, the Postal Service convened a special **Priority Mail Summit** on September 4, 2002,with the objective creating an action agenda that included better delivery performance, consideration of classification changes, and sharing of ideas in cost containment and reduction. Since the date of that meeting, APMU, working together with COO Donahoe and his staff, continue to develop plans to implement some of the ideas discussed at that meeting. As a direct result of the Priority Mail Summit, COO Donahoe has designated nine regional service representatives to respond rapidly to any problems of Priority Mail delivery. This important change was effected within 60 days of the Priority Mail Summit. Since then, Priority Mail service appears to have improved significantly. APMU is hopeful that this change will be the forerunner of other changes that can be made to improve the Priority Mail product under current law.

Statement for the Record of Gary L. Poelstra, President of the Association of United States Postal Lessors (AUSPL) Before the Committee on Government Affairs Of the United States Senate

November 19, 2003

Thank you for the opportunity to submit this statement for the record. My name is Gary L. Poelstra, and I am President of the Association of United States Postal Lessors. I am submitting this statement on behalf of the AUSPL.

Although it is not that well known, many of the Post Offices throughout the country are owned not by the Postal Service but by the private sector, which lease the facilities to the Postal Service. The Association of United States Postal Lessors (AUSPL) represents those private sector owners.

Founded in 1981, the AUSPL is the largest nonprofit association for postal lessors in the country, serving more than 2,200 members nationwide. Our members range from owners of small, rural Post Offices to individuals and/or organizations owning multiple postal facilities, to still others who own more than 300 Post Office buildings.

Collectively, our members own approximately 30% of space leased by the United States Postal Service. The AUSPL Insurance Program, exclusively for our members, insures approximately 25 million square feet of space leased to the Postal Service.

Our mission is to help Post Office owners better manage their real estate investment, which is occupied by the Postal Service, and to help increase the efficiency of the postal system. We always strive to be positive and cooperative in our dealings with the Postal Service and its administrators. We have a tremendous respect for the Postal Service, and we appreciate the role it plays in American society, as well as the role we play in the postal system.

Private parties own more than 26,000 of the 35,000 Post Office facilities in this country and lease them to the Postal Service. Our members, the owners of many of these Post Offices, pay federal, state, and local taxes, abide by all local business and zoning regulations and have no immunity from federal, state or local law.

It should not be overlooked that the rental income to our members provides critical tax revenue to federal and state governments, to say nothing of the taxes paid by the tens of thousands of postal workers employed in these facilities. Local communities also depend on the real estate taxes we pay for the Post Office buildings we own and that are often the focal point of the community

We are concerned about the rhetoric we have heard about selling and closing small Post Offices, and the misconceptions that somehow this could save the Postal Service a

significant amount of money, or somehow appreciably increase its efficiency. The truth is that most postal facilities are leased, and thus have no resale value to the Postal Service.

These facilities not only provide crucial access nationwide to the Postal Service for millions of American citizens; they also represent much more than simple outlets for delivery. Leased Post Offices, often in rural areas, are critical to rural America. The Post Office is the lifeblood of a community. Without it, the most basic connection for rural America is lost. In many towns, the Post Office is the only representative of the federal government. At the Post Office, customers can register for the draft, apply for Social Security cards and have access to posted federal notices of all kinds.

In addition to delivering the mail, Postmasters assist people with reading mail and paying bills. Seniors rely on the Post Office to interact with fellow citizens as well as receive medication, which may be adversely affected by weather or stolen if left outdoors in a mailbox.

More than 55 million people live in rural America and are served by these facilities. We believe that purchasing stamps, sending parcels, Express Mail and other common postal services that might be provided by grocery stores, Wal-Marts, banks and ATMs do not equate to universal service nor the personalized service people receive at a Post Office.

While we understand it's necessary to streamline Postal Service's operations, and can appreciate the need to optimize sorting and regional distribution facilities, we do not believe small Post Offices should be closed as a cost-cutting strategy. It is simply not wise, efficient, or appropriate. It would save little money and do widespread damage.

Instead, all Post Office functions must be evaluated on their merits to the entire system and to the country, not just on an economic value. Because the majority of facilities under 6,500 square feet are leased, the Commission will not be able to realize any proceeds from the sale of these small Post Offices if such facilities are closed.

Approximately 70% of Post Offices in this country may be considered community or rural facilities. The USPS has portrayed these Post Offices as locations that are consistently losing money for the Postal Service. While postal *revenue* is collected where the mailer enters the mail system, the *cost* of delivering those same letters and parcels is carried by the Post Office that ultimately delivers the mail. Clearly, this method of accounting does not allow for a reasonable assessment of which facilities make money or lose money.

To infer that more than half of the Post Offices in the country lose money is simply not fair, nor accurate. Individual Post Offices cannot be expected to operate as stand-alone profit centers. All departments must work together as an organization to accomplish universal service just like Fed Ex and UPS.

The Postal Service employs hundreds of thousands of people nationwide. Its facilities, trucks and letter carriers symbolize the mail and the federal government. Changes to any of these icons will impact every community. Rural customers are not second-class citizens; they deserve access to postal services just like their metropolitan "cousins."

AUSPL is confident that Congress will maintain universal service and hopes that access to a Post Office for the citizens of small town USA will not disappear. The cost of the 10,000 smallest Post Offices is less than 1% of the Postal Service's total budget. An inquiry initiated by the Postal Rate Commission reported that rural Americans are 26% of the population, and they make up 34% of Americans with incomes below the poverty line. Please allow these folks continued access to a Post Office.

On behalf of all AUSPL members and citizens of this country, I thank you for the opportunity to submit this statement for the record, and for your serious consideration of these matters. Please feel free to contact us should you have any questions or desire further information.

Consumer Action

717 Market St.
Suite 310
San Francisco, CA 94103
415/ 777-9648

523 West Sixth St.
Suite 1105
Los Angeles, CA 90014
213/ 624-4631

Board of Directors

Gene Coleman
President

Jim Conran
Vice President

Molly Hopp
Treasurer

Ken McEldowney
Secretary

Candace Acevedo
Chris Bjorklund
William Kent Brunette
Trish Butler
Pastor Herrera, Jr.
Sue Hestor
Helen Nelson
Kay Pachtner
Patricia Sturdevant

The Honorable Susan M. Collins
Chairman
Senate Governmental Affairs Committee
304 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Collins:

Consumer Action is a nonprofit, membership-based organization founded in 1971. Consumer Action serves consumers nationwide through its network of 6,500 community based organizations, advocating for consumers in the media and before lawmakers. On behalf of our members, I appreciate this opportunity to provide our views to the Committee concerning the Report of the Presidential Commission on the U.S. Postal Service.

As the Committee initiates its review of the Commission report, Consumer Action wants to thank you for seeking input from postal stakeholders. We trust the Committee will take into account the full range of individuals, groups and communities that could be significantly impacted by implementation of the Commission's recommendations. It is our view that the true stakeholder in this regard is the American consumer who relies on affordable, accessible, and dependable mail service. Any changes in U.S. Postal Service operations or scope of service that would serve to undermine that reliance is a policy direction we hope the Congress will reject.

Consumer Action did provide testimony to the Commission during one of its field hearings. While a somewhat last minute addition to the hearing agenda, we nonetheless welcomed the opportunity to bring the consumer perspective to the Commission's deliberations. We remain concerned, however, that ours was a rather singular voice in the process. In reviewing the testimony sought by the Commission, in both its field and Washington-based hearings, it appears the Commission's primary interest was the concerns of those business entities that are either large volume users of mail service or compete with the Postal Service. Those concerns, while certainly legitimate, should not be the basis for any far-reaching changes in the Postal Service that may adversely affect the American public. It is not at all clear that the public was sufficiently represented in the range of opinion received by the Commission that we assume significantly influenced its findings and recommendations.

In general, Consumer Action is not convinced of the need for any wholesale change in the mission of the U.S. Postal Service, as the Commission suggests. To redefine the mission in order to meet the priorities of bulk mailers, vendors and competitors at the expense of the consumer is unwarranted and unwise. Purchasers of postal services should not have to experience either rate increases or reductions in service in the pursuit of a new "business model" for the U.S. Postal Service. There is little history to suggest that such an effort would be successful. The Postal Service should operate in the most efficient and cost effective manner possible but it is not a business; it is a

service. The American consumer wants and needs this service and is reasonably satisfied with how it is currently being provided.

More specifically, I want to point out several of the Commission's recommendations that are of particular concern.

The governance structure recommended by the Commission that aims to emulate a private sector corporation and stipulates "business acumen" as the primary qualification for membership on the Board of Directors is flawed. It would allow for no bipartisan input from the Congress and seems designed to forestall any consumer representation on the Board.

The new Postal Regulatory Board appears vested with authority to undermine the concept of universal service, especially in light of the recommendation that the 1970 Act be amended to clarify the Postal Service mission as providing "essential" services "by the most cost-effective and efficient means possible at affordable and, where appropriate, uniform rates."

A careful reading of the Commission report with respect to post offices suggests an opening of the door to whole scale closing of smaller and more remote post offices.
If economic criteria are the deciding factor without benefit of community or Congressional input, there appears a real risk that many communities, particularly in rural areas, may be denied a convenient and accessible postal facility.

The Commission finding that the Postal Service has a "unique attrition opportunity" to right-size the work force by as much as a nearly 50% cut does not augur well for the interests of the consumer. It is likely a prescription for reduced service, less efficient and timely service, and a serious decline in consumer satisfaction with mail service.

A notable failure in the Report is to address the subsidies the Postal Service gives to industrial mailers who send first-class business mail and bulk advertising mail at heavily discounted postage rates. The basis for these discounts is supposedly the costs avoided by the Postal Service. In fact, the discounts are significantly greater than the costs avoided and yet the Commission is recommending that these unjustified discounts continue for current recipients. Clearly, it is the average individual postal customer who is paying for these breaks to the large mailers through higher first class mail rates.

Consumer Action supports efforts to ensure the financial viability of the U.S. Postal Service and urges the Committee to develop prudent legislation to accomplish that end. The primary goal, however, of any legislation must be affordable, accessible, and dependable mail service for the American public. There is no need or justification for shortchanging the consumer when to comes to the mail.

Sincerely,

Ken McEldowney
Executive Director

U. S. Senate
Committee on Governmental Affairs

Statement of
Diane J. Elmer
Vice-President – Delivery Logistics
Cox Target Media, Inc.
8605 Largo Lakes Drive
Largo, Florida 33773-4910

With respect to
Report of the President's Commission on
the United States Postal Service

November 19, 2003

Thank you for the opportunity to present you and other members of the Committee with the comments of Cox Target Media, Inc. and Valpak Direct Marketing Systems, Inc. ("Valpak") with respect to the report of the President's Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Service*, July 31, 2003.

Valpak 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 210 franchises 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. 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.

It is because of Valpak's need for — and belief in — the Postal Service that we have been willing to make constructive criticisms when we felt it

necessary. For example, Valpak was an early critic of the Postal Service's inadequate capital investment plans, and a proponent of massive investment in, and modernization of, the Postal Service's infrastructure.

Moreover, Valpak has been an active intervenor before the Postal Rate Commission 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;
- Docket No. R2001-1, the last omnibus rate case which was settled;
- Docket No. MC2002-2, the precedent-setting negotiated service agreement ("NSA") case; and
- Docket No. RM2003-5, the pending rulemaking setting up rules for NSAs.

Generally, we believe that the Postal Rate Commission does a very good job in evaluating technical evidence establishing the cost of each postal product, and setting postal rates. In fact, the rate-setting process established by the Postal Reorganization Act works quite well. We reject as simplistic the notion that the Postal Service is doing just fine, and only needs to be given the flexibility to set its own rates to be a successful enterprise. So long as the Postal Service benefits from a statutory monopoly, it makes no sense that it have broad authority to set its own rates.

Naturally, we have been quite pleased with the current moratorium on rate increases as a result of the inadvertent overpayments by the Postal Service into the Civil Service Retirement System. However, the key postal issue facing

the Postal Service, Congress, ratepayers, and other stakeholders is not changing the way rates are set, or even what rates are charged in the short run, but what can be done to help the Postal Service contain its costs through increases in productivity and efficiency, both now and over the long run.

If the Postal Service actually were able 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.

Valpak enthusiastically supports the recommendations by the President's Commission that are intended to improve the Postal Service in performing its core mission. We appreciate the time the Committee on Governmental Affairs is investing in the current effort to investigate 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.

We would like to address several of those recommendations in these comments.

Mission — "Stick to Its Knitting"

The President's Commission recommends that the Postal Service focus on delivery of traditional mail, leaving electronic products and services to a well-served and innovative private marketplace. In the same vein, the Carper

bill (S.1285) states that "Nothing in this title shall be considered to permit or require that the Postal Service provide any special nonpostal or similar services."

Valpak completely supports the view that the Postal Service must be constrained so that it limits its business to the physical delivery of letters, flats, and parcels. Further, the Postal Service should not be competing with existing mailers.

The Postal Service faces an enormous task to modernize and streamline the postal network, improve service, and accomplish other needed improvements discussed by the President's Commission. It should focus all of management's attention and energy to this end, and not waste ratepayers' money in efforts to compete with the private sector in the provision of other services.

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 the 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 this Committee on November 5, 2003, at pages 27-28.

The President's Commission would fashion a new rate-setting process to allow greater flexibility to Postal Service managers while imposing firm price and spending discipline on the institution, so that rate increases are the **last** line of defense against rising costs, rather than the **first**. Inevitably, however, the postal monopoly, which will remain intact, tends to make rate increases the **first** line of defense against rising costs.

Valpak supports encouragement of higher productivity and greater efficiency, but the rate-setting process is ill-designed to accomplish that end.

Rate making, from inception to implementation, takes less time than the Postal Service claims. Moreover, much of the complexity of rate making is the direct result of decisions made by the Postal Service to resolve complex costing and rate design issues only within the context of omnibus rate cases.

The Postal Service cannot be entrusted with setting rates unilaterally. A strong, independent Postal Rate Commission/Postal Regulatory Board is needed.

Negotiated Service Agreements

NSAs have been held to be legal under the current law, so no legislative change is needed in this respect.

One NSA is now in place. The record supporting the first NSA indicates that the levels of volume needed to make NSAs successful cannot be achieved

easily, and that, unless a range of similarly situated mailers achieve similar NSAs fairly expeditiously, future NSAs may be unduly discriminatory. Over five months have elapsed since the Governors implemented the first NSA, without any other NSAs being filed.

Valpak believes that NSAs are inherently discriminatory and that difficulties which they pose often could outweigh their benefits. Further, serious questions exist as to whether the Postal Service can actually realize projected savings over the short (typically three year) duration of an agreement.

Valpak believes that NSAs 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.

Closing Facilities —
"Postal Network Optimization Commission" (P-NOC)

The President's Commission and the Carper bill both recommend an orderly procedure, patterned after that used by the Department of Defense, to help facilitate orderly closing and realigning of postal facilities, including retail offices, as well as processing, distribution, and bulk mail plants.

Valpak strongly supports the recommendations in the report of the President's Commission, and in the corresponding provisions in the Carper Bill, that deal with closing unneeded postal facilities.

Congress has consistently and vigorously opposed closing virtually any post office, no matter how small, how costly, or how unnecessary. Congress

likewise has opposed modernizing the postal network whenever such modernization would require closing and consolidating mail processing facilities that are no longer needed. Because of Congressional impediments, the Postal Service and its ratepayers are being saddled with billions of dollars in operating expenses that easily could be diminished, thereby reducing future rate increases.

Congressional restraints on cutting costs also impose a secondary, hidden cost that far exceeds the billions of dollars required to operate the facilities themselves. Such restraints send unmistakable signals that the Postal Service is still very much a government agency, and that Congress considers numerous policy/political objectives more important than improving productivity and efficiency.

Standardizing and Modernizing Facilities via Debt Financing

The President's Commission would have the Postal Service eliminate costly and obsolete postal facilities and, as part of any redesign of the mail processing chain, strive for standardization of its facilities in order to enhance productivity and efficiency. Valpak supports this recommendation, as well as others, designed to enhance productivity and efficiency.

The financing of substantial capital improvements, such as a network of modernized and standardized facilities, was not addressed explicitly by the President's Commission, although it would allow the Postal Service to retain earnings, subject to limits established by a Postal Regulatory Board. However,

limiting substantial modernization to the availability of retained earnings would require the Postal Service to undertake massive capital outlays on a strict pay-as-you-go basis, and would either require huge rate increases, or take far too long to implement.

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. We note that the statutory debt limit, when adjusted for monetary inflation and growth in mail volume since 1971, actually has been substantially reduced to a fraction of its original amount.

Promotion of Worksharing

Worksharing has been responsible for volume growth and quantum advances in the efficiency of the mail service, and in the effectiveness with which mailer needs are being met. Mailer innovations have added to overall savings. Compared with the postal systems of other countries, the U.S. Postal Service stands out as a pioneer and leader in this area.

Further progress is possible, and is adequately allowed under current law. The analysis needed to devise rates and classifications to encourage further worksharing is complex. Valpak believes that this analysis should be guided by accepted economic principles, and that regulatory review will continue to be necessary. After-the-fact review by regulators, triggered only by

mailer complaints, is not an appropriate method for rate making, nor is it likely to encourage worksharing as well as the existing system.

Postscript

While continuing to provide universal service to an expanding economy, the Postal Service is under increasing competitive pressures from electronic alternatives as well as from parties providing similar delivery services. Results of these pressures are being seen in declining market shares and declining volume per household, particularly First-Class volume. The Postal Service may not succeed in its mission if it is saddled with financial burdens beyond those reasonably associated with its operations, and beyond those that normally would be faced by an enterprise engaged in the provision of similar services. Indeed, it is economically inefficient to require the price of services to cover resource needs that bear no relation to the services themselves.

Accordingly, Valpak believes that the Postal Service, as an independent off-budget agency, should not be required to fund retirement obligations associated with prior military service of its employees. These military service obligations bear no relation to the costs of providing mail service or to the work history of those employees with the Postal Service. Some 90 percent of these costs relate to military service which occurred prior to the creation of the U.S. Postal Service in 1971. They are an excessive financial burden that is properly borne by the U.S. Treasury. The Postal Service needs to be able to compete on a level playing field. None of the Postal Service's private sector competitors are faced with such a financial burden.

COMMENTS OF
THE DIRECT MARKETING ASSOCIATION
On The Work Of
THE PRESIDENT'S COMMISSION ON THE UNITED STATES POSTAL SERVICE
Submitted To
THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

November 18, 2003

The Direct Marketing Association (The DMA) appreciates the opportunity to provide its views on the work of the President's Commission on the United States Postal Service and on the topic of postal reform, generally.

The Commission was charged with the responsibility of articulating a vision for the future of the United States Postal Service. The Commission's mission was of vital importance to The DMA's members and, indeed, all American businesses and consumers who use the U.S. mail. The DMA believes that the Commission met its goal by presenting a road map that builds on the past efforts of the Congress and the Postal Service, tackles tough decisions, and truly embraces the future.

Founded in 1917, the Direct Marketing Association is today the largest trade association in the database-driven direct and online marketing field, representing businesses – from small "mom and pop" operations to 53 of the Fortune 100 – in 52 industry sectors, including the nation's top catalogs, online marketers, retailers, manufacturers, financial institutions, publishers, healthcare, new media providers.

The DMA's members – for-profit as well as nonprofit – use a number of marketing channels. However, direct mail, including catalogs, has been – and remains – a primary marketing channel to reach current and prospective customers. In fact, direct mail in 2002 generated an estimated $634.4 billion in consumer and business-to-business sales. In addition, many DMA members employ U.S. Postal Service parcel and

expedited delivery services for their fulfillment operations and account for a substantial portion of the First Class mail stream.

In short, a viable U.S. Postal Service is vital to the future of The DMA's members and our industry.

According to the Commission, the most significant obstacle to this is a "legacy business model and structure counterproductive to the Postal Service's ability to perform its most vital function: ensuring the universal availability of reliable, affordable postal services."

The 33 year-old business and regulatory model, under which the U.S. Postal Service currently operates, provides neither the flexibility nor the incentives needed to ensure its own viability and, in turn, the growth potential for a very significant segment of the U.S. economy.

At the foundation of this model is a *de jure* monopoly that is under increased attack by rapid and ubiquitous technological advances and the digital communications revolution. The Postal Service is also being eroded by forces ranging from globalization to the changing nature of logistics and transportation networks. None of this could possibly have been foreseen by the architects of the Postal Reorganization Act of 1970. Moreover, they could not have envisioned a time when the prospect of a declining volume base, characterized as "sobering and credible" by the Commission, would be required to support an ever-growing delivery network. Most assuredly, this situation is unsustainable in the long-term or, as the Commission explained:

> Without significant modernization, we will all have three choices: dramatic service rollbacks; rate increases of an unprecedented scale; or falling further into debt, potentially requiring a congressionally approved taxpayer bailout.

Each of these three options is equally unacceptable for a system that today supports a segment of our economy that accounts for approximately 8 percent of our GDP — some $900 billion — and employs at least 9 million Americans. Consequently, The DMA supports the conclusion of the Commission that, while the challenges are substantial, the opportunities for improvement are abundant and, therefore, comprehensive reforms should begin now, in advance of an impending crisis that would be unnecessarily costly and limit available options for the future.

The DMA's comments submitted to the President's Commission earlier this year set forth as an overall objective that the underlying business and regulatory model of the USPS be updated in a manner:

- that will ensure the continued availability of a system that provides users with a gateway to every home and business in our nation and beyond;
- that requires the continuous pursuit of overall efficiency;
- that affords users an opportunity to achieve the lowest combined costs for the delivery of their mail; and,
- that the Commission's deliberations and recommendations should reflect the desirability of maximizing the benefits that competition can bring to our nation's postal system and its economy.

The DMA believes that Commission's report, with its thirty-five recommendations, embraces these core principles.

Many of the recommendations add the Commission's imprimatur to the Postal Service's 2002 Transformation Plan developed at the urging of the Senate's Committee on Governmental Affairs. Still other Commission recommendations build on and reflect the past efforts of the House's Committee on Government Reform.

The DMA recognizes that not everyone will agree on every aspect of the Commission's recommendations. Nevertheless, we respectfully ask members of Congress to give prompt consideration to those recommendations that would require legislative action, and to provide meaningful support for action on those falling within the ambit of the Postal Service's existing authority.

The Commission's recommendations are infused with the notions that reforms must be couched within a dynamic context, if they are to serve future needs in an efficient and effective manner. Implicit in this notion is that the Postal Service must be empowered to right-size its infrastructure, its workforce, and its service offerings as future circumstances may dictate. These are concepts that The DMA believes should be first and foremost among those enacted by the Congress, along with the flexible, incentive-based rate-setting process envisioned by the Commission.

Nevertheless, while we support the creation of a model that will accommodate necessary changes, The DMA is cognizant of the need to distinguish between matters of operational efficiency and public policy and of the need to determine the appropriate degree to which the Congress should delegate authority in these arenas.

For example, the Commission noted that while universal service and the postal monopoly – as currently perceived - remain vital to the Nation and its economy, this may not always be the case; that a review of this status over time may be appropriate, necessary and possible, without sacrificing affordable access to essential services. We agree with this idea in principle, however, in such matters, Congress may wish to explore retaining some degree of authority over this determination rather than vesting the matter wholly in a regulatory entity as proposed by the Commission.

On the other hand, the process recommended to facilitate infrastructure changes may require involvement by the Administration and the Congress to a degree that could

impede the dynamic of operating in a way that maximizes efficiency. Although some degree of insulation from the political process is desirable for realigning the Postal Service's network of over 400 logistics and processing facilities – the mechanism outlined by the Commission would appear to limit the Postal Service's modernization efforts to times when a special commission appointed by the President – with the advice and consent of the Senate – would submit recommendations requiring final approval by both the the President and Congress.

While almost all of the Commission's recommendations address the necessity of updating the antiquated laws governing the Postal Service, one recommendation proposes a change to the recently enacted Postal Civil Service Retirement System (CSRS) Funding Reform Act (Public Law 108-18). This Act, which adjusted the Postal Service's annual contribution to fully fund its remaining CSRS liability, also imposed a new and unique burden requiring the Service to fund CSRS benefits earned by its employees while serving in the military. The Commission concluded that the $27 billion associated with this obligation should be borne by taxpayers, not ratepayers, as is the case for all other federal government entities. The DMA shares this view.

In closing, The DMA fully agrees with the Commission's conclusion that "[T]he American people deserve the most capable and efficient Postal Service modern techniques and 'best execution' strategies can make possible…." Moreover, The DMA agrees with the Commission's view that "an incremental approach to Postal Service reform will yield too little too late…." Therefore, The DMA urges the Congress to adopt a comprehensive approach to postal reform encompassing the range of Commission recommendations.

Envelope
Manufacturers
Association

October 29, 2003

Via Fax: 202-224-2693

The Honorable Susan M. Collins
United States Senate
Senate Russell Office Building, Room 172
Washington, D.C. 20510-1904

Dear Senator Collins:

Thank you for the opportunity to provide our views on the Report of the President's Commission on the Postal Service. Our association represents the envelope manufacturing and packaging industry and we have 170 members who make their living producing products that go through the mail stream or through private delivery companies. We also have a sister organization, the EMA Foundation for Paper-Based Communications, which studies postal issues and works to ensure the viability of the paper-based communications industry.

The overriding theme of the Commission's report is that if reform measures proposed by the Commission are considered, the Postal Service could see a long healthy future if it embraces reform and certain doom if it does not. Our association, in general, supports this theme and we find the recommendations provided by the Commission both sound and logical. We also believe that the current business model cannot be made to work and that significant reform of the Postal Service is needed, not a piece-meal effort.

Postal Retirement and Health Care Benefits

The Commission did a very good job telling the story of the development of the current retirement and healthcare benefits system. The CSRS Retirement Reform Legislation embodied in P.L. 108.18 did address the issue of overfunding of CSRS retirement obligations but a legislative compromise created an escrow for the last year of the retirement "savings" application that has created a great deal of controversy between the Postal Service, the Administration and mailers. We believe that postal ratepayers should not fund Military Pensions. To do so would be wrong. We also believe that Congress should have a carefully developed and thoughtful plan, provided by the Postal Service, that addresses both the issues of financial transparency and allocation of these resources before approving the release of the escrow. We do believe that the escrow should be released, not to do so would further escalate the mail volume drop. We also believe that some mechanism should be put in place to hold the USPS accountable for the released escrow "savings." It is our hope that this matter can be resolved just before reform moves forward.

The Postal Regulatory Board

The Commission has proposed a Postal Regulatory Board to replace the current Postal Rate Commission and provide the board with expanded powers. This Board would be the definer of universal service, to be changed as circumstances warrant; the definer of the limits of the postal monopoly and the control of the mailbox. This Board would establish the baseline rates and the rate ceilings under which the Postal Service's non-competitive

500 Montgomery Street
Suite 550
Alexandria, VA 22314-1565
703.739.2200
Fax 703.739.2209
www.envelope.org

products must be priced; it would decide when prices for competitive products are too low which might indicate a subsidized rate, as well as have the power to define what subsidy means. It would have the power to determine which costs to attribute and to police unreasonable discrimination. In addition to rate regulation, it would have the power to determine which products the service can offer; approve changes in service standards and, effectively, clamp a ceiling on postal labor costs by determining what constitutes pay comparability.

In our view, these are a great many powers to concentrate on a single regulatory body. Our concern is also that the Commission appears to be tacit on the issue of judicial review authority for decisions that the Regulatory Board would make of significant magnitude. We are also concerned that the definition of universal service may be difficult to achieve. There have been a number of studies done on various aspects of universal service and none have provided a conclusive definition. We fail to see how one Regulatory Board could come up with a comprehensive definition. In addition, the issue of opening up the mailbox is of equal complexity. The issue involves the security and privacy of each American household and the security of the mail itself. How could a Regulatory Commission accomplish this when for over 30 years the mailing industry and many academics have wrestled with this issue? It is our hope that the committee will carefully consider the powers that it wishes to have granted to the Postal Regulatory Board before it fully endorses the recommendation of the Commission.

Incentive-Based Rates Process

The new incentive-based rate ceiling process recommended by the Commission would encourage the Postal Service to be more productive and to save costs rather than increasing rates first and thinking about saving costs later. We believe that if the rate ceiling is appropriately constructed, the Postal Service would be incentivised to rein in spending and improve efficiency and productivity. We further commend the Postal Service on its current cost-cutting efforts, but far more is needed to keep up with the revenues being lost from the restructuring of the mail. Every time the Postal Service loses a single piece of First-Class Mail, it must generate three pieces of Standard A mail to receive the same revenue contribution. Cost-cutting alone will not produce a postal system that encourages more mailing -- fundamental transformation will. We can no longer pass through costs to end-users, processes must be redesigned so that costs are continually reduced or mail volume declines will continue at present rates.

The rate design process proposed also establishes a rate ceiling. It involves two levers: the inflation factor that allows rates to increase within limits to reflect rising costs, and the productivity factor. The issue becomes, what factor or factors do you use. The Commission leaves this up to the Regulatory Board. We believe that some thought should be given to the price indices that are used. The issue of the escalator is also another important task. We feel that there should be a clear definition of the "baskets" and "bands" and a justification given for each as part of the charge to the Postal Regulatory Board if it is charged with designing this structure.

We feel that there is flexibility in the process of setting rates after the initial rate case and we feel that the process proposed is adequate. But we also feel there needs to be standards for cost transparency in the allocation of costs among the products and services that are under review by the Postal Regulatory Board. This would also mean a higher level

of cost allocation than is currently used in many rate proceedings. This could cause a great deal of difficulty in rate proceedings as it places more discretion in the hands of the cost allocator (the Postal Service) and less in the hands of the cost litigator (the rate payer). In addition, it may require more investment in full cost software and the issue of appropriate disclosure must again be considered.
Further related to the above issue, we support the idea that predictable rate increases every three years are much better than the current system of one year or two year rate cycles with unknown levels and timing that creates difficulties for all in terms of annual budgets. We must remember that predictable increases are a central theme of the entire rate setting process. This concept was echoed frequently in testimony before the Commission.

The Commission has cast a broad net in the definition of "non-competitive products." The Commission believes that appropriate restrictions against cross subsidy of competitive products can be accomplished without divulging USPS competitive information. We believe that this will be a real challenge given the categorization of "non-competitive products."

In the context of its rate setting and examining process, we also find that the Commission is reluctant to provide the USPS with "unlimited ability to change service standards." The Commission delegates to the Board the authority to set service standards in a roundabout way. The Commission recommends that, "Requests for opinions must be made by the Postal Service whenever a proposed change will result in a negative impact on more than 10 percent of aggregate volume at the class or subclass level or on more than 10 percent of delivery points. If the proposed change will impact more than 25 percent of aggregate mail volume for a class or subclass of mail, or 25 percent of delivery point, the opinions of the Postal Regulatory Board shall be binding on the Postal Service. Otherwise, the opinion is advisory." Why not simply provide this flexibility to the USPS? Why create a more complicated service standard system? Service standards should be established by the USPS, measured and not deviated from. They are a reason customers do business with the USPS, they don't need regulation.

Labor Reform

The Commission's report spends a great many pages dealing with the issue of labor reform. They talk about the pay and benefits of postal workers, of benefits being set by statute and creating an incentive-based culture. The EMA Foundation's Institute for Postal Studies provided a detailed submission to the Commission in which they focused more on the process of labor relations rather than changing the collective bargaining model. There is no perfect collective bargaining model in their view. If both parties agree in a timely manner, if benefits are determined on a fair and equitable basis, and if both parties are served, then the process works. Our view is that as long as the process keeps the parties moving closer to an agreement rather than farther away from an agreement, then the process is working. If both parties feel that it is helpful to place a required mediation step in the process, then they should have flexibility to do so.

We felt hat it is important to keep in mind that the USPS will have a significant number of employees eligible for retirement in the next decade; and through attrition, the USPS will be able to downsize by simply not hiring replacements. Every time a position is vacated, the USPS needs to carefully evaluate the need for that position or whether or not it can be accomplished by another position. It will take a very flexible collective bargaining process to

get through many of the changes that labor and the USPS will go through over the coming years as postal retirements increase. It is critical that the Congress not do something that makes the process more cumbersome.

We feel that mediators and/or arbitrators are only as good as they are educated in the issues before them. The current law offers an opportunity to provide information during fact finding. The Commission's report does not mention the standards for fact finding in great detail.

We find that pay comparability is a difficult issue for anyone to discuss. The Commission recommends that all individual components for total compensation be subject to the collective bargaining process. The issue becomes, what do you compare these compensation programs with? What is comparable? Do you work in pay-for-performance issues? Is no layoff considered a negotiable benefit after 25 years? if would be difficult to apply these requirements to current postal employees, so would they only apply to future employees? We also feel that once you start "hard wiring" pay comparability issues into legislation, you may create a collective bargaining process that is more cumbersome.

At this point, our recommendation is to keep focused on changes that improve the process and let management and labor deal with the benefits through the process. We do believe that there are some unintended consequences that were caused by the application of FECA to the Postal Service but which can be fixed through amendatory legislation that clarifies eligibility and transfer issues.

Resizing the Postal Service

You cannot cost-effectively deliver a smaller quantity of mail by fewer workers through many of the "legacy" networks that the USPS has created. There is no doubt that in a decade the Service will not need all of the facilities it has today, nor will it have the workers to staff these facilities. We felt that the USPS is already addressing this issue in its "Network Realignment" initiative and that work should and must go on and Congress should be kept continuously informed about the process.

We further believe that an independent commission, chartered but not governed by Congress, should be used to evaluate closures of post offices and plants based on agreed upon criteria. This process would enable an objective evaluation of the service provided by facilities to be closed and a determination made as to how communities could be alternatively serviced. The Commission has proposed the Postal Network Optimization Commission. This, or a commission of like type, would seem to be an appropriate way forward.

What is a post office? With over one-third of patrons only going to the post office to buy stamps, it is apparent that much lower cost alternatives to satisfy the consumers' need for stamps do already exist. The USPS needs to be encouraged to educate the consumer on stamp buying alternatives, put kiosks in convenient locations and identify alternative locations by improved signage, commercials and other devices to see if consumers can be educated to purchase stamps through other means. We are aware of the USPS's current efforts in this regard but maybe more is needed if we still are getting 35 percent of patrons purchasing stamps only.

We also feel that legislation and regulations have got to establish a broader view of a retail facility and maybe through the use of private/postal combined facilities can be operated at a lower cost and still service the needs of a service area. The important issue to keep in mind is how can the community best be serviced, not who should do the servicing.

The Commission also explored the issue of Negotiated Service Agreements and other work sharing discounts as useful strategies to consider as you blend a new postal system together of public and private partnerships. We agree that Negotiated Services Agreements need to have an established process that is streamlined and which enables entrance into these agreements in a more timely fashion. We also feel that other work sharing discounts are an important part in improving postal productivity and shifting the cost burden of mail processing into the private sector. As long as these discounts are consistently and fairly applied, we feel they should be continued.

Other Administrative Actions

The Commission has recommended other outsourcing initiatives; procurement reform and management of real estate assets as issues that the USPS should look into. These may not require legislative reform but nevertheless, they should be given priority consideration as they may contribute to further cost reduction.

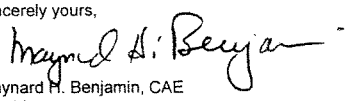
Technology

One of the final areas the Commission dealt with is the issue of new technology and intelligent mail. We find ourselves in full agreement with the findings of the Commission. It is an important goal that all customers should have the ability to track their mail, but all customers should also have the option of not tracking their mail. Mail tracking and tracing does have several privacy implications and the USPS needs to carefully evaluate these before moving forward.

One final issue that we have with regard to technology is the need for some benchmark for investing in new technology. As you know, as the fortunes of the USPS reversed in the last several years, capital spending budgets were cut, equipment purchases were curtailed and one has to wonder how much productivity was lost because the right equipment was not in the right place at the right time. At the same time, you have to ask if we spent so much money on capital equipment in the last five years, how come total factor productivity has improved so dramatically with a more limited capital equipment input? There are no easy answers but a system of measurement needs to be put in place to determine if investments in new technology are appropriate and additive to the organization and customers.

We thank you for the opportunity to provide our comments. We will be delighted to provide additional information upon request.

Sincerely yours,



Maynard H. Benjamin, CAE
President

TESTIMONY of

Steve Bartlett,

President of the Financial Services Roundtable

The President's Commission on the United States Postal Service:
Setting the Stage for Effective and Swift Reform of the Postal Service

BEFORE the
Senate Committee on Governmental Affairs

November 5, 2003

Chairman Collins and Members of the Committee, thank you for the opportunity to submit the Financial Services Roundtable's views on the recommendations of the President's Commission on the United States Postal Service and the growing need for effective reform of the United States Postal Service.

The Financial Services Roundtable (www.fsround.org) represents 100 of the largest diversified financial services companies providing banking, insurance, and investment products and services to American businesses and consumers. Roundtable member companies provide fuel for America's economic engine, accounting directly for $12.4 trillion in managed assets, $561 billion in revenue, and 1.8 million jobs.

Our member companies generate and receive as much as 25% of all mail handled by the Postal Service. In 2002, our industry spent an estimated $12 billion in First Class and Standard postage. Considering mail both sent and received, the financial services industry is one of the Postal Service's most valuable customers and a healthy future for the Postal Service is essential to our members.

We have carefully assessed the July 2003 report issued by the President's Commission on the U.S. Postal Service and, as described below, we enthusiastically support many of the Commission's recommendations for legislative and administrative reforms needed to ensure the viability of the Postal Service.

The Commission's report provides an important foundation for a true restructuring of the Postal Service that will ensure the preservation of universal service. We urge Congress to swiftly pass the meaningful systemic changes that will enable the Postal Service to better serve its customers, control costs, and maximize efficiencies for the long term.

We also call on Congress to heed the Commission's recommendations to allow the Postal Service to spend savings accrued from changes in its Civil Service Retirement System (CSRS) obligations, and relieve the Postal Service of any obligation to pay retirement benefits of postal employees earned through military service. Swift action on these two measures is vital to the continued health of the Postal Service.

Postal Reform is Needed Now

The Postal Service faces considerable financial and institutional troubles including huge long-term liabilities for workers' compensation claims, retirement costs, and retiree health care costs. At the same time, First-Class mail volumes have markedly declined over the past four years as more postal consumers turn to less costly business communications such as email, fax, and Internet transactions. With the slump in postal revenues expected to continue, the Postal Service may be forced to radically raise rates, cut back on its provision of universal mail service, or seek a substantial government bailout.

In light of the bleak outlook of increasing financial instability for the Postal Service, the Financial Services Roundtable commissioned a study in May 2003 entitled "Creating a Customer Focused Postal Service." This study concludes that a substantial overhaul of the Postal Service is the only way to secure its long-term success. With the release of the Presidential Commission's recommendations, the time is right for Congress to pass meaningful postal reform legislation.

Without effective reform, we fully expect that the Postal Service will seek frequent, large postal rate increases. (There already have been three rate increases since 2001.) Businesses need stable postal rates in order to facilitate a multitude of investments that will grow the economy. The Roundtable urges Congress to take quick action on the following recommendations for the good of the Postal Service, its employees, postal users, and our nation's economy:

Corporate Governance: Enhance Pricing Flexibility and Accountability

The Roundtable supports USPS pricing flexibility with accountability to an independent Postal Regulatory Board for meeting postal rate constraints, for financial performance, and for quality of service.

We also agree with the Commission's recommendations that the governance structure be informed by best business practices, and we are encouraged by the recommendation that postal decision makers should have substantial experience in the financial and business sectors, including running private-sector enterprises and large organizations.

Structural Reform: Maximize the Use of the Private Sector

The Roundtable fully supports the Commission's recommendations that the private sector play a more significant role in Postal Service operations. Postal Service functions that can be performed better and at lower cost by the private sector should be outsourced to the private sector. Further, we support the Commission's recommendations that the Postal Service be given greater flexibility to enter into negotiated service agreements. We strongly endorse the effective use of negotiated service agreements to more closely meet customer needs.

Innovative procurement strategies will be particularly useful in light of the billions the Postal Service spends on supplies, equipment, transportation, and fuel. We also support the Postal Service's efforts to partner with small businesses, including supermarkets, drug stores, and banks, to sell postal products at their facilities. There are also opportunities for the Postal Service to manage its real estate holdings more successfully to strengthen the Postal Service's financial outlook without disrupting its core business of providing universal service.

Infrastructure Improvements: Optimize Facilities, Improve Technology, and Customize Rates/Negotiated Service Agreements

We support the Commission's call to close obsolete facilities, improve technology needed to streamline operations and control costs, and enhance customer-focused rates and services through Negotiated Service Agreements. We agree that standardization of many postal processes will improve productivity and reduce costs. The Roundtable also supports appropriate investments in new technologies to improve service and efficiencies. An Intelligent Mail program to improve the Postal Service's mail-tracking services, for example, will create important savings by improving logistics management.

Labor Improvements: Support an Appropriately-Sized Workforce and Improve Employee-Management Relations

The Roundtable agrees with the Commission that the size of the Postal Service workforce is a key issue to controlling costs. We support a Postal Service workforce that is appropriately sized to enhance the effective implementation of cost savings, while ensuring the appropriate level of flexibility. We also support an incentive-based culture that will encourage Postal Service employee excellence and productivity. The Congress should weigh carefully the Commission's recommendations to improve the collective bargaining process.

Allow the Postal Service to Spend Savings Accrued from Changes in its Civil Service Retirement System (CSRS) Obligations

The Postal Civil Service Retirement System Funding Reform Act (Public Law 108-18) was an important step toward allowing the Postal Service to use overpayments of its CSRS retirement obligations to reduce its debt to the Treasury and keep postage rates down. Unfortunately, the Act calls for Congress to hold the surplus in escrow after 2005. As the Presidential Commission has recommended, we urge Congress to abolish the escrow account as it will impede the Postal Service's revenue and rate planning, and will immediately trigger higher postal rates for all users in 2006. The Postal Service has stated that failure by Congress to remove the escrow will by itself cause a 5.4% rate increase in 2006, and even larger increases in later years.

Relieve the Postal Service of the Obligation to Pay Retirement Benefits of Postal Employees Earned through Military Service

Further, Congress must relieve the Postal Service of the obligation to fund the military service component of its CSRS retirees' pension payments that was included as part of the Postal Civil Service Retirement System Funding Reform Act. Requiring the Postal

Service to cover military service benefits is unfair and unjustified, in part because the majority of these costs relate to military service performed before the creation of the Postal Service. We agree with the Presidential Commission's call to promptly return responsibility for this portion of retiree benefits to the Department of the Treasury.

Conclusion

As the discussion over postal reform progresses, the members of the Financial Services Roundtable look forward to working with Chairman Collins, Ranking Member Lieberman, and members of the Committee reforms needed to sustain a viable Postal Service that can maintain affordable rates and efficient services. We recognize the challenges involved in an undertaking of this complexity and appreciate your comprehensive approach to enacting meaningful reform of the Postal Service. We also note that while a considerable overhaul of the Postal Service is necessary, progress toward such reform should not delay the immediate enactment of the CSRS and Military retirement changes that are needed. Again, thank you for the opportunity to share the Financial Services Roundtable's views on postal reform.

United States Senate
Committee on Governmental Affairs

Hearings on Postal Reform

Richard B. Dingman
Senior Counsel

Free Speech Coalition, Inc.
8180 Greensboro Drive, Suite 1070
McLean, Virginia 22102-3860
(703) 356-6912; Fax (703) 356-5085
freespeech@mindspring.com

November 19, 2003

The Free Speech Coalition, Inc. ("FSC"), now in its tenth year of operation, is a broad alliance of nonprofit organizations and for-profit companies which help nonprofits raise funds and carry out their programs. FSC is particularly concerned with the preservation of the rights of nonprofit advocacy organizations. This diverse group came together in 1993 to defend the interests of Americans who want to participate fully in the formation of public policy in this country without undue governmental interference and restriction.

FSC is concerned that some of the loudest voices and largest organizations within the nonprofit community will try to use postal reform to advance their own narrow interests and will invoke the powerful yet baseless charge of "fraud" to urge this Committee to reverse the Postal Service's recent improvements in its Cooperative Mail Rule. This testimony will help explain why the attack on the Postal Service's changes to the Cooperative Mail Rule is not truly based on wrongdoing, but rather the self-interest of those who invoke that epithet.

USPS COOPERATIVE MAIL RULE

Before the recent modification, the Domestic Mail Manual, DMM 670.5.3, provided that:

> A **cooperative mailing** may be made at the Nonprofit Standard Mail rates only when **each** of the cooperating organizations is **individually authorized** to mail at the Nonprofit Standard Mail rates at the post office where the mailing is deposited. A cooperative mailing involving the mailing of any matter **on behalf of** or **produced for** an organization not itself authorized to mail at the Nonprofit Standard Mail rates at the post office where the mailing is deposited must be paid at the applicable Regular or Enhanced Carrier Route Standard Mail rates. The mailer may appeal the decision under G020. [Emphasis added.]

On May 6, 2003, the Postal Service proposed adding the following language to this section of the DMM:

> Exception: this standard does not apply to mailings by a nonprofit organization authorized to mail at Nonprofit Standard Mail rates soliciting monetary donations and not promoting or otherwise facilitating the sale or lease of any goods or service. [68 Fed. Reg. 23937-39.]

In the final regulations published October 9, 2003, the following language was added:

> Exception: effective November 13, 2003, this standard no longer applies to mailings by an organization authorized to mail at Nonprofit Standard Mail rates soliciting monetary donations to the authorized mailer and not promoting or otherwise facilitating the sale or lease of any goods or service. This exception applies only where the organization authorized to mail at Nonprofit Standard Mail rates is given a list of each donor, contact information (*e.g.*, address, telephone number) for each, and the amount of the donation or waives in writing the receipt of this list. [68 Fed. Reg. 58273.]

DIVERSE INTERESTS WITHIN NONPROFIT COMMUNITY

FSC would have preferred the original language proposed by the Postal Service with changes it recommended in Comments filed with the Postal Service, but supports the Postal Service's final regulations. The Cooperative Mail Rule — as previously enforced to prohibit "no-risk" and other types of contracts between nonprofits and fundraisers — operates to the disadvantage of smaller nonprofits and those that do not receive taxpayer financing. The Postal Service's motivation may have been well-intentioned, but it operated unfairly, and has served the interests of certain large nonprofits at the expense of small nonprofits. It has now been fixed

"No-risk" contracts are generally contracts between nonprofits and professional direct mail agencies which have expertise in marketing, and which have confidence from their experience that they can help the nonprofit can raise money through direct mail. Because of this experience and confidence, they are willing to help protect the nonprofit from adverse financial effects if their judgment is wrong and adequate funds are not raised.

The fact that there are spokesmen within the nonprofit community who oppose the Postal Service's efforts to narrow the Cooperative Mail Rule and permit "no-risk" contracts may seem surprising, in that the proposed change would impose fewer restrictions on the ability of nonprofits to mail at nonprofit rates. Why would any nonprofit, or any spokesman for nonprofits, oppose a government agency's acknowledgment that nonprofit organizations should have greater rights? The answer is not that difficult to understand when one understands that there are different economic interests within the nonprofit community.

FSC's nonprofit members are generally smaller, depending on the use of nonprofit mail rates to facilitate their communication of a vision and to demonstrate a program of effective action, to both their current and prospective contributors and members. The ability to enter into no-risk contracts helps start-up and small nonprofits. The availability of no-risk contracts provides alternatives which the boards of directors and officers of nonprofits can consider when they seek professional assistance with their fundraising. The only apparent justification for the Postal Service's intrusion into this regulatory arena is the belief that the nonprofit organizations are incompetent, and in need of protection from a wise and beneficent government.

On the other side of the nonprofit community, some large nonprofits derive the bulk of their operating income from federal, state, or local governmental sources, or are heavily funded by private foundations and corporations. These large nonprofits often point to the fact that they have low fundraising cost ratios, neglecting to mention that the favorable ratios come as a result of their acceptance of government funds where large grants can be obtained for the price of filling out an application. These large nonprofits frequently have sufficient resources to retain in-house fundraising staff and do not need to use outside agencies. These large nonprofits often seek changes in the law, or even accounting regulations, to make it more difficult to start up new nonprofits, which they view as potential competitors in the areas that they have "staked out" and believe that they own. These large nonprofits often work hand in glove with some regulatory agencies, willing to speak and sometimes testify in Congressional and administrative hearings against smaller, upstart nonprofit organizations for committing alleged accusations of impropriety. When the government agencies are able, such as through

press releases, joint press conferences, etc., they reward these favored nonprofits for their "public-minded" ways. Associations representing these large nonprofits can be expected to be supportive of a broad Cooperative Mail Rule, which is in their narrow self-interest. Their narrow self-interest needs to be seen for what it is, and the value of their comments reduced accordingly.

Other organizations expressing concern about nonprofit organizations being unregulated confuse the private guidelines of nonprofit organizations with compelled governmental standards. If an organization of professionals chooses to adopt voluntary guidelines (even if they characterize them as "ethical" rules) for their own behavior, that may be a commendable exercise. If that same organization would seek to use the might of the federal government to impose those so-called ethical standards on other organizations, that is not a commendable exercise. There are many prior illustrations of this principle in other areas. For example, when state bar associations chose to define the unauthorized practice of law as including real estate settlements, that permitted them to use their so-called "ethical" standards to put out of business settlement firms which did excellent work for customers at a reasonable price. Ethical rules have been used for anti-competitive purposes by trade associations for years. The problem continues within the nonprofit community.

ANALYSIS

The Postal Service's interpretation of the previous Cooperative Mail Rule to prohibit nonprofits using no-risk contracts from mailing at nonprofit rates was set out in Postal Service Publication 417, Nonprofit Standard Mail Eligibility, in Chapter 5, entitled "Cooperative Mailings." It provides that:

> A cooperative mailing is a mailing produced by an authorized organization that "cooperates" with one or more organizations to **share the cost, risk, or benefit** of the mailing." [Publication 417, Section 5-1 (emphasis added).]

Publication 417 goes on to explain this statement:

> For determining whether a mailing is eligible for the Nonprofit Standard Mail rates, the Postal Service evaluates the answers to these questions:
>
> - Who **devised, designed**, and paid for the mailpiece?
> - Who paid the postage on the mailing, either directly or indirectly?
> - How are the profits and revenues divided from the mailing or an enterprise it supports?
> - What risks are entailed with the mailing or with an enterprise it supports and **who bears these risks**?
> - Who makes managerial decisions about the content of the mailing or the enterprise it supports?
> - What are the participants' intentions and interests? [Publication 417, Section 5-2.1 (emphasis added).]

This prior interpretation of the Cooperative Mail Rule is ill-conceived, having no bearing on the issue of whether a nonprofit is sending its own mail, as opposed to being used as a subterfuge to send the mail of a commercial entity. Consider the following questions:

- If a small mailer does not have the in-house capability to "devise" or "design" a mailpiece, why should that mailer be penalized vis-a-vis a larger mailer with a large in-house fundraising staff? What salutary public policy would be served?

- If a start-up or other small nonprofit organization wants to test the concept of direct mail fundraising, without having a substantial nest egg to advance postage, printing, and other costs, and a direct mail agency wants to attempt to prove to the board of directors of the nonprofit organization that the public will support its nonprofit program if asked, and offers to do a few, or many mailings, on a no-loss, no-risk basis, why should the start-up organization be prohibited from using nonprofit rates? What salutary public policy would be served?

- If an established nonprofit organization wants to "try out" a new professional fundraising counsel with a test mailing or two, in which the nonprofit is

> immunized from losing money, why should it not be able to mail at nonprofit rates? What salutary public policy would be served?

In each of these cases, why should the Postal Service's broad, general rule against no-risk contracts override the collective judgment of those directors of a nonprofit organization in whom the law vests the duty to manage, and the actions of those directors and officers who have a statutory responsibility to be fiduciaries for that nonprofit organization, when they choose to enter into a no-risk contract?

On the other hand, if a large nonprofit which is substantially government-funded, and which has plenty of money in the bank, wants to engage in direct mail fundraising, why is it somehow more deserving of the use of nonprofit mail rates than a nonprofit organization that has a policy against accepting such government funds?

If, as the Postal Service admitted, "the application of the cooperative mail rule was having a serious effect on [nonprofits'] ability to solicit donations and, in some cases, might threaten the existence of many nonprofit organizations" (68 Fed. Reg. at 23938), what merit is there in such a rule? Surely, the Postal Service, in carrying out its important government functions, should not seek to penalize small charities. The salutary public policy that led to the recent modification of the Cooperative Mail Rule demands that the government get out of the business of deciding to support certain nonprofit organizations and penalizing their perceived competitors.

CONCLUSION

FSC applauds the Postal Service for its recognition that relief is needed to "help ensure that nonprofit organizations, particularly those who cannot implement fundraising campaigns in-house, can obtain the professional assistance needed to obtain the donations necessary to fund their vital programs." Id. In fact, the recent modification of the Cooperative Mail Rule evidently arises out of the Postal Service's concern to provide appropriate relief.

FSC urges the Committee to resist pressure from certain large nonprofits and allow these improvements in the Cooperative Mail Rule to stand to the benefit of diversity among nonprofits.

Greeting Card Association

October 28, 2003

The Honorable Susan Collins,
Chairman
Government Affairs Committee
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Collins:

The Greeting Card Association (GCA) is pleased to respond to your request for comments on the report of the President's Commission on the United States Postal Service. As one of the early proponents of such a Commission, GCA believes that the report represents the most important thinking on postal reform in the last thirty years. Such independent and impartial reviews of postal operations are rare, and therefore, should receive thoughtful consideration.

GCA Testimony
In presenting testimony to the Commission, GCA argued for three main principles (a copy of our statement is attached for your reference):

- Preservation of universal delivery service – to every household, at uniform (and affordable) rates, six days a week;
- A change in the Postal Service's business model away from concentration on high- volume, low cost bulk mailings and back to the core public service function; and
- Strong and efficient regulatory protection for the captive postal customer- since the Postal Service will remain a monopoly for the greater part of its traffic.

In support of these principles, GCA argued for the need to preserve prior review of postal rate increases by a strong regulatory body. We also advocated for refocusing the Postal Service's business model on the types of mail that go to the core value Americans place on the mail (and that bring in the most net revenue per piece) – that is, personal correspondence such as letters and greeting cards.

Recent opinion research has shown that the American people hold the postal system in high regard, they trust it more than other communications media, and they prefer it for messages with high personal or emotional content. The value American households place on the personal mail they receive carries over to the business and advertising mail that also forms part of the "Mail Moment" (the Postal Service's term for the experience of collecting and reading one's incoming mail).
If personal mail were to disappear, much of the utility the postal system offers to commercial users would disappear with it.

The Postal Service has devoted a great deal of time and resources to maximize the volume of Standard ECR, Parcel Post and Express Mail. However, even if wildly successful, those efforts would produce only limited results. Even implausible volume increases in these categories (100 to 200 percent) would increase net revenue only about two percent. On the other hand, if the Postal Service would focus on promoting its brand strength (i.e. universal service and the value recipients place on receiving desirable mail), even modest increases in the more lucrative First-Class category would provide a substantially greater return. In addition, much bulk mail is (as the President's Commission noted) subject to diversion into e-media. Where the choice between hard-copy mail and an electronic bill or bank statement is based on cost to the sender, e-media have a distinct advantage. This is yet another reason why the Service's evolving business model should focus less on maximization of bulk volumes.

President's Commission on Postal Reform -- Comprehensive Reform

With this background in mind, GCA greatly appreciates the scope and integrated nature of the Commission's recommendations. We want to offer a few general comments on the report as a whole and to share our thoughts on some of the individual recommendations as well.

Our first and most important observation is that the Commission has provided a postal reform package that covers all areas necessary to achieve true reform. GCA was pleased that the Commission addressed the critical area of Postal Service costs, a topic not dealt with in earlier legislative postal reform proposals. GCA disagrees with those who have suggested that the Commission's report validated those earlier legislative efforts because they reflected 80 percent of what the Commission recommended. GCA respectfully submits that 80 percent of a solution is no solution at all. President Kennedy, for example, would not have been satisfied if NASA had proclaimed his pledge to go to the moon fulfilled because they had gotten an astronaut 80 percent of the way there. Neither should the public be satisfied with postal reform that ignores the 20 percent of the problem that accounts for 80 percent of Postal Service costs. GCA is sensitive to the political difficulty in addressing workforce issues and facility streamlining, but it is that very difficulty that reinforces the need to make progress in these areas if in no other. It is, however, the prospect of the benefit from effectively managing these issues that allows GCA to accept, with considerable reservation, other Commission recommendations that run counter to what we proposed.

Prior Review of Rates

As stated previously, GCA strongly advocated that the practice of prior review be maintained in any future rate making system. The Commission, on the other hand, took the position that the length of time needed to argue rate cases was an intolerable burden upon postal management, prohibiting it from operating effectively in the market place. The Commission recommended a price ceiling system under which rate increases could occur at the sole discretion of the Postal Service provided they were held below the rate of inflation. Although GCA believes that prior review is the only way of guaranteeing fair and equitable treatment for captive mailers, we would be willing to accept an alternative system such as that proposed by the Commission in exchange for the benefits derived from the Commission's *comprehensive* cost control recommendations.

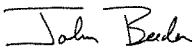
Reservations

In addition to our deep concern over the Commission's price setting recommendations. GCA also has identified other critical issues, not addressed in the Commission's report, that need to be resolved in order to transform the Commission's outline of a rate setting system into a complete and fully functional mechanism for establishing postal rates.

Rather than review them here, however, we would encourage the Committee to maintain the approach taken in the most recent versions of postal reform legislation by Rep. John McHugh and Sen. Tom Carper. This approach avoids specific rate setting provisions in favor of giving a newly constituted and empowered regulatory body general guidelines and objectives for creating a new system. The system would combine the speed and efficiency the President's Commission called for with protection of the basic standards of fairness and preservation of broad public access to the postal system at reasonable cost. Specific rules and procedures would be determined in a subsequent rulemaking proceeding. GCA views this strategy to have the greatest chance of legislative success. It would defer major points of controversy between postal stakeholders and allow issues to be resolved in a forum better suited to dealing with the complicated, but nevertheless critical, science of postal ratemaking.

GCA is grateful for your interest in Postal Reform. We ask that you embrace both the scope and vision of the Commission's recommendations and craft legislation in response that is equally broad and encompassing. While strategies for solutions may differ, GCA is convinced that of the problems identified by the Commission are all valid and should be addressed in any postal reform legislation. With your leadership, we believe the Committee will find the common ground necessary to craft a bill that will permit the Postal Service to more effectively manage its costs, operate effectively in a new competitive environment and preserve this vital public institution for the new century. GCA stands ready to assist you in any way possible, and we would be happy to answer any questions you may have regarding this statement.

Sincerely,



John W. Beeder
President, Greeting Card Association
Senior Vice President, Hallmark Cards

Institute For Research on the Economics of Taxation (IRET)

Statement of Michael Schuyler
Senior Economist, IRET

The Presidential Postal Commission's Message:
Better Cost Management Needed

Submitted to
Senate Committee on Governmental Affairs

Hearing
The Report of the Presidential Commission on the U.S. Postal Service:
Preserving Access and Affordability
November 5, 2003

My name is Michael Schuyler. I am a senior economist with the Institute for Research on the Economics of Taxation (IRET). This statement briefly discusses some of the key issues regarding the final report of the President's Commission on the United States Postal Service.

The President's Commission on the U.S. Postal Service was created because of concern about the Postal Service's financial viability and uncertainty about what role the organization should play in the 21st century. The organization's declining net income in the late 1990s, its losses in 2000-2002, and the growth of the Internet as an alternative to the mail have all contributed to the sense of concern.

Like the separate examination of the Postal Service's pension obligations to CSRS retirees, the Commission's analysis produced unexpectedly good news. Consider some of the options the Commission was able to reject:

1710 Rhode Island Avenue, N.W., 11th Floor, Washington, D.C. 20036
Phone: (202) 463-1400 Internet: www.iret.org

■ Will the Postal Service soon be so deeply in the red that it will need large and continuing Congressional appropriations? No. Provided that badly needed reforms are implemented, the Postal Service can meet its breakeven target for at least the next 15-20 years.

■ Has six-day-a-week mail delivery become an unaffordable luxury? No. Although less frequent delivery has often been mentioned as an option, the Commission concludes that it can and should be continued, again provided reforms are made in other areas.

■ To break even financially must the Postal Service close all money-losing small post offices, and, more generally, must it drastically curtail expensive service to the most rural areas? No. While the Commission recommends closing unneeded post offices in conjunction with providing more community-based outlets for postal services, it emphatically and repeatedly states that small post offices should remain open where they are needed to maintain universal service standards. Nor does the Commission think it necessary to reduce the level of service in even the most rural areas, if appropriate changes are made to other aspects of the Postal Service's operations.

■ Are the Postal Service's problems so severe that nothing short of privatization can be effective? No. The Commission concluded that more modest reforms would allow the Postal Service to satisfy its financial and level-of-service objectives. (To be sure, many economists would prefer privatization, thinking that it would produce still greater gains in efficiency and general welfare.)

If the Postal Service had a healthy bottom line, these conclusions would not be especially notable or impressive. As the Commission accurately reports, however, the Postal Service's financial problems are extremely serious. Unless its problems are addressed, "the Postal Service will have three choices: dramatically roll back service, seek a rate increase of unprecedented scale, or fall even further into debt, potentially requiring a significant taxpayer bailout." (*Commission Report*, p. 5.)

The Commission's insight was to realize that the Postal Service's financial problems lie primarily on the cost side: the agency's costs are unnecessarily high relative to the level of customer service it provides. With better management of labor and capital costs, the Postal Service could simultaneously achieve its breakeven objective while maintaining its level of customer service. For example, the Postal Service could capture large cost savings without lowering service quality by rationalizing its out-of-date network of facilities. With a more

efficient network, it would not be paying for as much capital and labor, and it would be realizing greater productivity from the capital and labor it does use. Likewise, the agency could strengthen its bottom line without compromising quality by outsourcing more mail processing work in cases where the private sector can deliver both lower costs and the same or better level of service than the Postal Service can achieve internally.

Do the Commission's numbers really add up, or was it exaggerating the potential cost savings? One of the strongest indications that the numbers are indeed realistic — provided the recommended reforms are undertaken — is that while many parties have objected to some of the report's specific proposals, there have been few challenges to the Commission's claim that better practices would yield extremely large cost savings.

To some extent the Postal Service can reduce its costs and raise its productivity on its own initiative. It has recently taken some excellent steps in that direction under Postmaster General Potter. But in many cases the agency needs statutory help from Congress in order better to control its costs.

Virtually no one thinks it likely or even desirable that every proposal in the Commission's report be implemented. In picking and choosing, though, it is vital to understand that improved cost management is the foundation on which any successful effort to stabilize the Postal Service's finances must rest. Unless many of the Commission's cost-control recommendations are implemented, reform efforts will fail and the Postal Service will soon be in much worse trouble than it is now. In other words, it would not be sufficient to adopt many of the Commissions suggestions in other areas but reject most proposals related to better cost management. If that happens, the agency's financial problems will continue. It will become steadily harder to hold down postal rates. Pressure to relax service standards, especially in hard-to-serve areas, will increase. The threat to taxpayers will grow. And privatization will look increasingly attractive.

The Commission subtitled its final report "Making The Tough Choices To Preserve Universal Mail Service." One might wonder why a strategy that would allow the Postal Service to break even, keep postal rates reasonable, safeguard universal service, and protect taxpayers should be a tough choice. The answer may be that some of the most promising cost-control reforms are likely to be contentious. For instance, if the Postal Service follows the recommendation to outsource more mail processing where doing so would save money while

maintaining quality, some groups may object and urge Congress to block the outsourcing. Labor law reforms would also produce major cost savings that would help protect performance standards and universal service. Under current law, for instance, the Postal Service is not supposed to pay higher compensation than what the private sector pays for comparable work, but there is no mechanism to enforce that standard. (Most observers, although not all, have concluded from the evidence that a substantial postal pay premium now exists.) A related problem is that the Postal Service is required, by law, to provide several expensive fringe benefits; it needs, but lacks, the ability that most employers have to put those benefits on the table in labor negotiations. Some groups, however, have announced that they like the current rules and will vigorously oppose any changes. As one more example, efforts to rationalize the Postal Service's network of facilities may also be controversial.

With regard to closings and consolidations, two entirely legitimate concerns should be mentioned: the actions taken should not be arbitrary and should not be politically motivated. To ensure a fair process, the President's Commission suggests relying on a panel similar to the military base closing panels. If Congress decides to take this route, a refinement consistent with another point in the Commission's report that may ease concerns of some members of Congress would be to instruct the panel that no facility is to be closed or consolidated if it is needed in its present form to maintain universal service standards.

The report of the President's Commission has been compared to the *Transformation Plan* that the Postal Service issued in April 2002, but, in fact, the two plans' long-run recommendations are 180 degrees apart. The *Transformation Plan* calls for the Postal Service to become a Commercial Government Enterprise by expanding in markets beyond traditional mail delivery, like e-commerce, warehousing, logistics, and retailing. The President's Commission, in contrast, recommends that the government entity concentrate on its core market. The Commission's approach is more sensible. The Postal Service's Commercial Government Enterprise model relies on the unrealistic assumption that the Postal Service can pick up easy money in markets where it will face stiff competition from private-sector businesses. As the Commission correctly observes, however, the Postal Service rarely has done well in markets beyond its monopoly and often has lost money in them. Moreover, Postal Service forays beyond its core market distract its management's attention, are unfair to private-sector businesses whose markets the Postal Service enters, and stray from the mission that Congress gave the Postal Service. (The laws Congress has passed to shield certain postal products from direct competition–namely the private express statutes and the mailbox monopoly–provide a good

indication of the boundaries of the core market. By that dual-monopoly test, the Postal Service's core products are first-class mail, standard mail, and periodical mail.)

Some recommendations in the Commission's report probably should be rejected. For instance, the Commission proposes giving the Postal Regulatory Board (a more powerful replacement for the current Postal Rate Commission) authority to change the scope of the postal monopoly and the definition of universal service in the future. These are decisions that should be made by Congress and not delegated. Fortunately, provisions like these can be dropped without compromising the plan's essential cost-control features.

The Commission also suggests allowing the Postal Service to change its rates with less regulatory oversight. The Postal Service has long sought this power, and it has the advantages that it would speed rate changes and decrease regulatory costs. It would not be good policy, however, because the result would be less protection against the Postal Service using income from products within its postal monopoly to cross-subsidize its non-core products in competitive markets. If the Postal Service were privately owned, the analysis would be different. Economists can show that cross–subsidies are not a major problem at regulated private-sector companies because investors there do not want any products to be deliberately subsidized by other products since the cross-subsidies would reduce overall profits. But because the Postal Service is owned by the government, it lacks that internal barrier to cross-subsidization, which means that current regulatory safeguards should be retained.

A strategic plan that is based on weeding out unnecessary costs, focusing on the core market, and maintaining service quality might be characterized as practical minded rather than glamorous. In developing this back-to-basics strategy, the President's Postal Commission has indicated how the Postal Service can successfully meet the goals laid out for it by Congress. The plan can only work, however, if, with the help of Congress, many of the cost-management reforms the Commission recommends are adopted.

INTERNATIONAL PAPER

JOHN C RUNYAN
SENIOR PUBLIC AFFAIRS MANAGER-FEDERAL

1101 PENNSYLVANIA AVENUE NW
SUITE 200
WASHINGTON DC 20004

T 202 628-1223
F 202 628-1368
John.runyan@ipaper.com

November 21, 2003

The Honorable Susan Collins
Chairman, Senate Government Affairs Committee
SD-340 Dirksen Senate Office Building
Washington, DC 20510-6250

Dear Senator Collins,

Thank you for your recent letter requesting International Paper's views on the issue of postal reform. As the leading U.S. producer of mailing-related paper products, IP has a keen interest in this debate and a significant financial stake in its outcome.

We estimate that IP produces 22% of the more than 10 million tons of paper that flow through the U.S. Postal Service each year. This represents approximately 6% of our company's total annual revenue, employing more than 12,000 of our 60,000 US employees. Our mills in Bucksport and Jay, Maine are both directly involved in the production of paper grades that travel through the mail system as magazines, catalogs and other high-end business publications. This business is acutely sensitive to postal rate increases, which have an immediate dampening effect on mail volume. The rate increases during the 2001-2002 time period, for example, resulted in profit loss to International Paper of more than $50 million.

We applaud the report of the President's Commission on the Postal Service. The recommendations provide an excellent starting point for debate and a path forward for reforms that can create genuine rate stability. For example, the Commission's recommendations on financial transparency and governance issues should be strongly considered. Likewise, its suggestions on providing flexibility to the rate-setting process appear to be very positive steps toward a more effective postal system.

While the Commission's report provided an excellent overview of the USPS retirement system, it does not include specific recommendations to correct the situation that has developed where postal ratepayers are being asked to fund a portion of postal employee pensions for accrued military service. IP believes that ratepayers should not be required to pay the portion of an employees pension based on military service and that this situation should be corrected quickly as one of the committee's top priorities.

IP believes strongly that the overriding goal of any reform effort should be to provide for a more efficient postal delivery system that provides a predictable process for moderate rate increases allowing for optimal business planning by the nation's $900 billion mailing industry. The President's Commission on the Postal Service has provided a valuable starting point for discussion of comprehensive postal reform and we look forward to working with you and the members of the Committee as this process begins.

Sincerely,

John Runyan

November 11, 2003

Jim Courter
Chairman

Merrick Carey
Chief Executive Officer

Loren Thompson
Chief Operating Officer

Don Soifer
Executive Vice President

Daniel Gouré
Philip Peters
Vice Presidents

Bonner Cohen
Robert Holland
Senior Fellows

The Honorable Susan Collins
Chairman
Senate Governmental Affairs Committee
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Senator Collins:

Congratulations on your strong leadership for much-needed reform of the U.S. Postal Service, both as Chairman of the Governmental Affairs Committee and previously as a Committee member.

I understand that you are seeking comments relating to the recommendations of the recent Presidential Postal Commission and how they might best be translated into effective legislation. I wanted to pass along the enclosed letter, which I and ten other former Base Realignment and Closure (BRAC) Commissioners wrote last month to Majority Leader Frist and Speaker Hastert.

The letter describes the success of the BRAC process and the resulting savings for U.S. taxpayers. It suggests that, "because of its vast and outdated infrastructure, the U.S. Postal Service would benefit from the same kind of dispassionate review that we applied to the Department of Defense."

I hope that our views are helpful to you in your important efforts. If I or my staff can be of any assistance to you in achieving this valuable goal, please do not hesitate to contact me or Don Soifer at 703.522.5828. Thank you.

Very truly yours,

Jim Courter
Chairman

Enclosure

1600 Wilson Boulevard, Suite 900 • Arlington, VA 22209 • Phone: 703.522.5828 • Fax: 703.522.5837
http://www.lexingtoninstitute.org email: mail@lexingtoninstitute.org

October 1, 2003

The Honorable Bill Frist
Majority Leader
United States Senate
Washington, DC 20510

The Honorable Dennis Hastert
Speaker of the House
United States House of Representatives
Washington, DC 20515

Dear Speaker Hastert and Majority Leader Frist:

We, the undersigned Base Closure and Realignment Commissioners (BRAC) are impressed with the recommendation of the President's Commission on the U.S. Postal Service to institute a facility-closing effort similar to the BRAC efforts at the Department of Defense. Through four BRAC rounds we were able to achieve 97 base closings and 55 major realignments. This resulted in net savings to taxpayers of over $16 billion through 2001; and over $6 billion in additional savings annually.

The proposed panel would consider closing or consolidating unneeded postal processing and distribution facilities, while assessing the concerns of communities and other interested parties. The Commission also recommended that the Postal Service be given flexibility to close some of the nation's lowest-activity post offices. Because of its vast and outdated infrastructure, the U.S. Postal Service would benefit from the same kind of dispassionate review that we applied to the Department of Defense.

Jim Courter

Alan J. Dixon

Harry C. McPherson

Howard "Bo" Callaway

Al Cornella

Peter Bowman

Arthur Levitt

Josue Robles, Jr.

Beverly B. Byron

Robert D. Stuart, Jr.

Duane H. Cassidy

Jim Courter
Chairman, Base Realignment and Closure Commission, 1991 and 1993
Member, U.S. House of Representatives, 1979-1991
CEO and Vice Chairman, IDT Corporation

Alan J. Dixon
Chairman, Base Realignment and Closure Commission, 1995
Member, United States Senate, 1981-1993

Peter Bowman
Former Commander, Portsmouth Naval Shipyard

Beverly Byron
Member, U.S. House of Representatives, 1978-1992

Howard "Bo" Calloway
Secretary of the Army, 1973-1975

General Duane Cassidy
Commander in Chief, U.S. Transportation Command, 1987-1989

Al Cornella
Owner, Al Cornella Refrigeration Service
Member of the Board, South Dakota Chamber of Commerce

Arthur Levitt
Chairman, Securities and Exchange Commission, 1993-2001
Chairman, American Stock Exchange, 1978-1989

Harry C. McPherson
Special Counsel to President Lyndon Johnson, 1965-1969

Josue Robles, Jr.
Major General, United States Army (Ret.)

Robert D. Stuart, Jr.
U.S. Ambassador to Norway, 1984-1989
Former CEO, Quaker Oats Company

Comments of Magazine Publishers of America
to the
Committee on Governmental Affairs
United States Senate
November 2003

The Magazine Publishers of America (MPA), the premier trade association of the consumer magazine industry, is pleased to have the opportunity to provide our perspective on the July 2003 report and recommendations of the President's Commission on the United States Postal Service. We also commend you for your willingness to address this difficult and important public policy issue.

MPA has approximately 240 domestic magazine publisher members who collectively publish about 1400 magazines. Virtually all of them use the United States Postal Service to deliver their magazines to subscribers. MPA members' magazines provide broad coverage of domestic and international news in weekly and biweekly publications, and publish weekly, biweekly, monthly, and quarterly publications covering consumer affairs, law, literature, religion, political affairs, science, sports, agriculture, industry, and many other interests, avocations, and pastimes of the American people. Our membership is broad and diverse, but all magazine publishers share one common objective: ensuring an affordable and reliable postal system providing universal service into the foreseeable future.

MPA has always been an active participant in postal issues -- in legislative and administrative matters, in matters before the Postal Rate Commission including omnibus rate cases and classification cases, and as a strong advocate for postal reform. If our industry is to thrive, our nation's postal system must meet the challenges of the 21st century.

While most consumer magazine publishers sell copies to readers on both a subscription and a single copy basis, the subscription channel is today, and for

the foreseeable future will continue to be, the major component of magazine circulation in the United States. The percentage of circulation coming from subscriptions has grown to the point where about 85 percent of circulation is subscription copies; the Postal Service delivers almost all of these copies. In addition, magazine publishers use the Postal Service extensively to support subscriptions (sending acknowledgements, invoices, and renewal notices) and to attract new subscribers (sending promotions and special offers for magazines and related products).

We would like to begin our comments by expressing our appreciation to President George W. Bush for his initiative in establishing a Commission on the United States Postal Service and commending the Commission's thorough analysis and careful review of the important issues currently facing the Postal Service. The Commission's strong recommendations provide a basis for the kind of postal reform that will help ensure the efficiency, affordability, and stability of the system for the coming decades. Below, we discuss our perspective on the key recommendations of the President's Commission.

1. The postal system should be maintained as a fundamental service for all Americans.

MPA supports the recommendations of the President's Commission that the Postal Service continue its mission of providing "high-quality, essential postal services to all persons and communities" (page xi) and that it continue as a governmental entity that combines its historic and still vital public service mission with a modern business-minded approach.

In keeping with this important mission and recognizing that the Postal Service is the least-cost provider of "last mile" delivery services, we agree with the Commission that "the Postal Service should maintain its current mail monopoly, and also retain its sole access to customer mailboxes." (page 32). It

should also continue to fulfill its current universal service obligation. We do, however, recognize that the Postal Service's mission and the scope of its universal service obligation and monopoly may need to be reconsidered at some point in the future.

Furthermore, as part of the Postal Service's public service mission, we agree with the Commission that the "existing preferences for favorable rates for the mailing of periodicals and non-profit correspondence should be maintained." (page 67). Our nation's postal law has long accorded special recognition to magazines, newspapers, and books for their educational, cultural, scientific and informational value.

Indeed, facilitating the nationwide distribution of the printed word was a fundamental justification for the original establishment of America's government-sponsored postal system. Beginning with the 1792 Post Office Act, and reaffirmed in every major revision of postal law since then, successive Congresses and Administrations have agreed that facilitating and encouraging the distribution of periodicals through the mail serves the national interest.

The historical recognition in postal law and policy for the important role magazines, newspapers, and books play in educating and informing the public is as important today as it was when the national postal system was first created over two hundred years ago.

2. The Postal Service's Board of Governors should be transformed into a corporate-style Board of Directors. Furthermore, Directors and members of the Postal Service's regulatory board should be selected based upon experience and expertise. The scope of authority granted to the regulatory board must be narrowed significantly.

We appreciate that the President's Commission took seriously its charge to determine "the most appropriate governance and oversight structure for the Postal Service" (Appendix A), recommending that the "Postal Service Board of Governors should be transformed into a corporate-style Board of Directors" with all Directors "selected based on business acumen and other experience necessary to manage an enterprise of the Postal Service's size and significance." (page 171). While we recognize that thoughtful questions have been raised by the Postmaster General about the political implications of the specifics of the Commission's proposal, we believe that as a general proposition, the Postal Service would be best served by having a corporate-style Board with highly-qualified Directors. Furthermore, consistent with having a corporate-style Board, we agree with the President's Commission that the Postal Service should comply with applicable SEC reporting requirements.

The President's Commission also recommended that the Postal Rate Commission be reconfigured as a Postal Regulatory Board with authority over a broad range of issues—including pricing, the scope of universal service, the postal monopoly, and pay comparability—with members selected based on "demonstrated experience and professional standing." (page 171).

We agree with the President's Commission that protecting the public interest requires a regulator with appropriate authority over pricing and quality of service, particularly if the Postal Service is granted additional management flexibility. As the Postmaster General recently stated before the U.S. Senate Committee on Governmental Affairs, "with an increased level of management flexibility comes an increased level of oversight. This provides the necessary balance to protect the public interest."

We, however, have concerns regarding whether it is appropriate for one regulatory body to have such wide-ranging authority and whether it is possible for one regulatory body (no matter how experienced its members) to have the skills

necessary to oversee such a broad range of issues. We also question whether the authority over certain issues that the Commission would cede to the regulator might more appropriately be retained by the Congress (e.g., scope of the monopoly) or by the Postal Service itself (e.g., pay comparability via collective bargaining).

Based upon these concerns, we believe that the Postal Regulatory Board's authority should be limited to: overseeing the pricing and classification of postal products and services; ensuring that the Postal Service maintains or improves the quality of service that it provides; monitoring compliance with financial reporting requirements; and imposing remedies if pricing or service standards are not met. To carry out these responsibilities, the Board should be granted subpoena power.

Furthermore, to ensure that there is no confusion over the authority of the Postal Regulatory Board and the Postal Service, legislation should very clearly define which authorities will be retained by Congress and which will be granted to the Postal Regulatory Board and to the Postal Service under the new system, and under what conditions.

3. Efforts to reduce costs and rationalize the postal network should be encouraged.

We agree with the President's Commission that there is a significant need for the Postal Service to reduce its costs and rationalize its network. As the Commission stated in its report, "Stagnant mail volumes place intense pressure on the Postal Service to eliminate costs and inefficiencies and modernize systems and processes throughout its network." (page 75).

Fortunately, as noted by the Commission, the Postal Service is "developing and testing its network rationalization initiative, which strives to

create a sound analytical basis for redesigning the postal network. The strategy acknowledges the need to control high fixed infrastructure costs, which have little room to fluctuate with changes in mail volumes and revenues. It also aims to reduce costs, consolidate plants, improve consistency of service and standardize processes—all providing a strong start to efforts to rein in costs while improving overall efficiency and service." (pages 75-76).

We believe that efforts to rationalize and consolidate the Postal Service's network are vital to the Postal Service's future success. On this point, we note that with 47 percent of its career employees eligible for retirement by 2010, the Postal Service has a unique opportunity to reduce its costs and rationalize its network with minimal displacement. We strongly urge the Postal Service to take advantage of this opportunity.

While we recognize that questions have been raised about whether a Postal Network Optimization Commission (P-NOC), as recommended by the President's Commission, is the best method for rationalizing the network, we do believe that the Postal Service must be allowed to close unneeded facilities.

We also agree with the Commission that the Postal Service should expand retail access to its products and services to locations other than the post office, such as grocery stores, banks, and convenience stores. As the Commission stated, such a "revolution in retail access would allow postal customers to avoid the greatest inconvenience of a post office—having to make a special trip there." (page xviii). In addition to making access to postal products and services more convenient for retail customers, it would allow the Postal Service to reduce its costs.

4. Public-private partnerships for mail processing and transportation services are essential.

Despite Postal Service efforts to rationalize its network, the private sector (as evidenced by the more than $15 billion of postal "worksharing" that is currently performed by the private sector) will often be able to provide mail processing and transportation services at a lower cost than the Postal Service. Therefore, as recommended by the President's Commission, the Postal Service should continue to expand its partnerships with the private sector through the introduction of new worksharing discounts and Negotiated Service Agreements (NSAs) as well as through outsourcing efforts.

One promising way to expand the Postal Service's successful worksharing program, and thereby allow both mailers and the Postal Service to benefit from low-cost private sector providers of processing and transportation services, is for the Postal Service to introduce cost-based rates, i.e., rates that closely resemble the costs that the Postal Service incurs to handle a specific mailing. Because, under cost-based rates, prices for postal services would closely reflect postal costs, mailers would have incentives to reduce USPS costs for handling their mailings and to purchase from the Postal Service only the services that it can provide at a lower cost or better value than the private sector.

5. Pricing for postal products and services should be streamlined and modernized.

We also agree with the President's Commission's recommendation that the current pricing system should be replaced with one that, through the use of price caps or "rate ceilings," constrains rate increases to inflation minus a productivity adjustment factor. Such a pricing system would encourage cost-efficient practices, prevent large and unpredictable rate increases, and increase the Postal Service's managerial discretion.

The Commission proposes that the Postal Service be allowed to raise rates without prior review as long as the increase for individual baskets of products – e.g., mail subclasses – is less than inflation minus a productivity adjustment. As the Commission found in its report, the productivity factor is essential to this indexing system because, by "exert[ing] downward pressure on rates, [it] creat[es] the 'incentive' to reduce costs." (page 60).

Under such an "indexing" system, rate regulation could be significantly simplified and the scope and timing of rate increases made more manageable. Rate regulation in such a regime could, as recommended by the President's Commission, be structured around a complaint-based review system, through which rate or service complaints could be lodged with the regulator and dealt with promptly. As we noted in comments to the President's Commission, it is important that the review system prevent the Postal Service from meeting the rate ceilings simply by degrading the quality of service that it provides.

While this simplified system would make it easier for the Postal Service to change rates more frequently, we believe that, given the significant effort that is required for mailers to update their systems to reflect changes in postal rates, the Postal Service should not be permitted to increase rates more frequently than on an annual basis.

Also, as the President's Commission recognized, the system should include a streamlined process (based upon, as discussed above, a complaint-based review system) for negotiating individual rate arrangements (or NSAs) between the Postal Service and one or more mailers. This is particularly important because, although NSAs are permitted under current law, the NSA process has proved to be cumbersome.

We would note, however, concern with one of the Commission recommendations with regard to price increases. The Commission recommends

that the Postal Service be allowed to request increases in excess of established rate ceilings, citing for example, revenue shortfalls that might occur due to a precipitous drop in volume. In such a situation, the Commission recommends an "expedited review process" prior to rate implementation.

Congress must recognize that rate ceilings with exceptions do not provide the necessary balance to protect the public interest. While such a system would provide the Postal Service with pricing flexibility, it would not prevent large and unpredictable rate increases or encourage cost-efficient practices. Therefore, we strongly caution against allowing the Postal Service any exceptions that would allow it to increase rates above inflation minus a productivity adjustment factor.

6. Responsibility for CSRS costs relating to the military service of Postal Service retirees should be returned to the U.S. Treasury. Additionally, the escrow requirement in P.L. 108-18 should be eliminated.

In April of this year, Congress enacted legislation (P.L. 108-18) to prevent the Postal Service from overpaying for the retirement of its employees by $105 billion; as a consequence of this Act the Service was able to postpone the next rate increase until 2006. For this, we are grateful. The Act, however, also transferred the responsibility for funding more than $27 billion in Civil Service Retirement System pension benefits related to the military service of Postal Service retirees from the Department of the Treasury to the Postal Service and required the Postal Service to hold "savings" from the Act for years after fiscal year 2005 in an escrow account. We believe that both of these provisions of the Act should be repealed.

We agree with the President's Commission's position that the "responsibility for funding Civil Service Retirement System pension benefits relating to the military service of Postal Service retirees should be returned to the

Department of the Treasury." (page 140). As the Commission accurately stated in its report:

> ...it is inappropriate to require the Postal Service, as a self-financing entity that is charged with operating as [a] business, to fund costs that would not be borne by any private-sector corporation (costs associated with benefits earned while the retiree was employed by another employer). In addition, requiring Federal agencies financed through Congressional appropriations to cover the military retirement benefits of its employees still ultimately taps resources from the same appropriate revenue source—taxpayers. Requiring a self-financing Federal entity to follow suit is wholly different. It asks those who use the nation's postal system to subsidize the U.S. military every time they use the mail. (pages 125-126).

Further, requiring the Postal Service to hold the "savings" from CSRS reform in an escrow account would result in ratepayers continuing to overpay for postal services to a significant degree. In fact, just to fund the escrow account, the Postal Service would have to raise rates in FY 2006 by 5.4 percent in addition to what is justified based upon normal inflation. When combined with inflation, this would likely result in a disastrous, double-digit rate increase in FY 2006.

7. The collective-bargaining process and the relationship between Postal Service management and labor must be improved.

We agree with the Commission and with the Postmaster General that cost control is essential to the Postal Service's long-term viability. Despite years of investment in automation, personnel-related costs continue to comprise more than three-quarters of the cost of operating the Postal Service. Any meaningful effort to control costs must address this issue. We noted previously the Commission's finding that 47 percent of Postal Service career employees will be eligible for retirement by 2010. Again, we strongly urge the Postal Service to take advantage of this unique opportunity to right-size its workforce and reduce its personnel-related cost burden.

We also agree with the President's Commission and the Postmaster General that the collective-bargaining process and the relationship between Postal Service management and labor must be improved.

As the Postmaster General recently testified before the U.S. Senate Committee on Governmental Affairs, the addition of a mandatory mediation step between collective bargaining and interest arbitration could "help forge a final resolution" or at least "limit the issues that must be addressed" in arbitration. (page 12). Furthermore, allowing the parties to negotiate benefit levels, at least for new employees, could result in agreements that benefit both the Postal Service and its employees. Finally, the Postal Service and its employees should be required, or at least allowed, the opportunity to hold brief negotiations after an arbitration decision is announced to determine whether a mutually acceptable alternative is possible.

Equally important, as the President's Commission found, there are opportunities for improving the management-labor relationship: "In 2002, 184,329 grievances filed by members of the Postal Service's four major unions reached a 'second step' appeal, and 106,834 were pending arbitration." (page 127). We understand that, over the past year, Postal Service management and labor have made strides towards improving the grievance process. We encourage them to continue to do so using private sector best practices.

* * * * * * * * * *

In summary, we believe that the strong recommendations made by the President's Commission provide a basis for the kind of postal reform that will help ensure the efficiency, affordability, and stability of the system for the coming decades. In particular, we believe that:

- The postal system should be maintained as a fundamental service for all Americans.

- The Postal Service's Board of Governors should be transformed into a corporate-style Board of Directors. Furthermore, Directors and members of the Postal Service's regulatory board should be selected based upon experience and expertise. The scope of authority granted to the regulatory board must be narrowed significantly.

- Efforts to rationalize the postal network should be encouraged.

- Public-private partnerships, particularly for mail processing and transportation services, are essential.

- Pricing for postal products and services should be streamlined and modernized.

- Responsibility for CSRS costs relating to the military service of Postal Service retirees should be returned to the U.S. Treasury. Additionally, the escrow requirement in P.L. 108-18 should be eliminated.

- The collective-bargaining process and the relationship between Postal Service management and labor must be improved; the Postal Service should seize the cost control opportunity presented by the fact that nearly half its career workforce will be eligible for retirement by 2010.

We hope that you find our perspective on the July 2003 report and recommendations of the President's Commission on the United States Postal Service useful and look forward to working with you on this vitally important issue.

L.L.Bean INC
FREEPORT, MAINE 04033
Outdoor Sporting Specialties
www.llbean.com
TELEPHONE 207-865-4761

November 18, 2003

Senator Susan M. Collins
Chairman, Committee on Government Affairs
SD-340 Dirksen Office Building
Washington, DC 20510-6250

Dear ~~Senator Collins~~ Susan:

As President of the Mail Order Association of America (MOAA) I enclose a position paper on the final report of the President's Commission on the United States Postal Service.

The paper is limited to the pricing approaches that have been recommended by the Commission. There are other important issues that MOAA will address during the course of Congressional consideration of reform. Because, however, the pricing issues are of paramount importance, we want to focus initially on those issues.

It is essential that the Postal Service be given substantial pricing latitude and that the "price cap" be set at a workable level. Generally, all pricing issues are of vital importance to the future of the Postal Service. Therefore, those issues should be resolved by Congress, rather than delegated to the new Postal Regulatory Board, as has been recommended by the Commission.

We would appreciate an opportunity to meet with you to discuss these issues. We will be in contact with your staff to determine a suitable time for that meeting.

We appreciate your recognition of the vital importance of the Postal Service to the American people, and your continuing constructive role in ensuring the strongest possible Service.

Sincerely,

John

John Oliver
President
Mail Order Association of America

November 18, 2003

MAIL ORDER ASSOCIATON OF AMERICA

POSITION PAPER

ON THE FINAL REPORT OF

THE PRESIDENT'S COMMISSION

ON THE UNITED STATES POSTAL SERVICE

The Mail Order Association of America ("MOAA") represents the interests of Standard Mail users of the Postal Service, particularly mailers of catalogs.

The President's Commission on the United States Postal Service (the "Commission") has done an excellent job of assessing the current condition of the Postal Service, probable future volume and cost trends, and the actions that must be taken to enable the Service to continue to meet the needs of the country. MOAA concurs with the Commission's conclusion about the need for comprehensive reform, and most of the Commission's recommendations for change are well-designed to address the governance and structural problems that have been identified. MOAA supports most of those changes and anticipates further commenting upon and supporting them during the legislative process.

The Commission correctly concludes that First Class Mail volume trends, combined with an outmoded postal network, require fundamental changes in the structure and governance of the Postal Service. The bifurcation of control over the Postal Service into a Board of Directors that would be responsible for fulfilling the Service's obligations with maximum efficiency, and a Postal Regulatory Board that would have authority over major public policy issues is sound.

Unfortunately, however, the Commission's recommendations fail adequately to address one of the most vital areas requiring major change. Specifically, the Commission has recommended the institution of an incentive-based rate-setting methodology, but has failed to recommend how that methodology should work, except in the broadest of terms. Instead, the Commission recommends that the Postal Regulatory Board be given plenary authority to establish the entire rate-setting methodology. The report anticipates a delegation of rate authority to the Postal Service to the extent that rates are maintained within a ceiling established by the Board, but the Postal Regulatory Board has absolute authority to set that ceiling.

For many years Congressional committees have grappled, without success, with proposals for changing the methodologies to be used for postal rate and classification changes. Clearly, a Congressional resolution will be difficult. The Commission recommended alternative, that there be a complete delegation of authority to a three-member government commission, however, is not an acceptable approach. Such a broad delegation of authority is bad public policy and carries the grave risk that the Board will not grant to the Postal Service the rate flexibility that is essential if it is to carry out its mission.

A successful incentive price cap regime will have to be carefully designed if there is to be any hope of success. At the very least, the Congress should decide, and legislate, the principles that must govern incentive-based rates in sufficient detail to ensure that Congressional purposes will be carried out. Any system of rate "bands" or "baskets", as recommended by the Commission, or any other incentive scheme, must give the Service considerable latitude. The system must ensure that the Postal Service has the freedom to design its products and services in a way that allows it to adjust to changing cost and market conditions. The Postal Board of Directors and management cannot be expected to achieve the high level of efficiency anticipated by the Commission without being given substantial control over its products and prices. It is also essential that the rate ceiling be set at a realistic level, low enough to require vigorous cost control, but not so low that failure would be inevitable.

MOAA will advance approaches to incentive pricing during the course of legislative consideration, but wanted to bring this vital pricing issue to the forefront at the very beginning of Congressional consideration of the issues.

The McGraw-Hill Companies

November 20, 2003

Electronic Delivery

Hon. Susan M. Collins
Chair, Committee on Governmental Affairs
United States Senate
340 Dirksen Senate Office Building
Washington, D.C. 20510

RE: Initial Comments of The McGraw-Hill Companies on the President's Commission on the United States Postal Service Report - *Enhancing the Future: Making the Tough Choices to Preserve Universal Service*

Dear Senator Collins:

On behalf of The McGraw-Companies, I am submitting the following comments for inclusion in the record of the Committee's hearing on the President's Commission on the United States Postal Service report *Enhancing the Future: Making the Tough Choices to Preserve Universal Service* ("Report").

We wish to commend the Committee for seeking to address postal reform before it becomes a crisis, and thus less susceptible to a deliberative policy discussion. The Committee's expeditious movement of the *Postal Civil Service Retirement System Funding Reform Act of 2003* was a testament to its commitment to solving problems in this area.

The McGraw-Hill Companies, is among other things, a publisher of books and magazines. In providing these products to our customers, the Corporation makes extensive use of the U.S. Postal Service (USPS) to reach our customers across the nation. In particular, McGraw-Hill is dependent, you could say a captive customer, on the USPS for distribution of the well-known periodical ***BusinessWeek*** and a range of more narrowly recognized business-to-business titles.

McGraw-Hill has been an intervener in every omnibus postal rate and classification case since enactment of the *Postal Reorganization Act of 1970*. In addition, it has been active in the postal reform process, including participation in the trade associations: Magazine Publishers of America (MPA), representing high circulation consumer magazines, American Business Media (ABM), representing business-to-business magazines, and the Association of America Publishers (AAP), representing book publishers.

The President's Commission report is the result of a thorough and intensive evaluation of the USPS and the postal marketplace. The Commission surmounted a steep learning curve and delivered a thoughtful, concise and measured report. The Report provides a blueprint for action in a number of areas, and a platform for discussion in others.

The forecasted structural changes occurring in the postal marketplace are well known. These include a sustained and long-term decline in First-class mail, and a continuing erosion of revenues through electronic diversion from the mail stream. Add to this the hefty pension and other benefit liabilities facing the Postal Service and the need for comprehensive postal reform is apparent.

As a mailer, there are a number of recommendations in the Commission's report that are straightforward and should be incorporated in legislation with minor modification if any. From our perspective, several of these include:

- Retention of the current structure of the USPS as an independent establishment within the executive branch that is self-sustaining.
- Retention of its current mail monopoly and sole access to the mailbox to carry out its clarified mission to "provide high quality, essential postal services. . . ."
- Establishment of a new Board of Directors "with broad authority to oversee Postal Service operations," and to be chosen for their "business acumen and experience" in providing direction to an organization as large and important as the USPS.
- Review by the Board of Directors of the "entire management structure, size and cost" and implementation of measures to make USPS finances transparent.

- Consolidation and rationalization, through standardization, of the processing and distribution network, transformation of the retail network, and active management and disposal of excess real estate assets.
- Institution of procurement reforms to emulate commercial best practices.
- Separation of Postal Inspection Service costs that support the safety and security of the postal system shouldered by rate payers, from costs of broader law enforcement activated that should be borne by taxpayers.
- Elimination of current statutory salary caps.

While the improvement in operations and reduction in costs from these changes would be significant, the issues with the largest impact on the USPS's financial condition lie in more intractable areas. These include: (1) funding of Civil Service Retirement System (CSRS) military and volunteer service pension benefits; (2) size of Postal Service workforce; and (3) implementation of a streamlined new rate-setting mechanism.

1. CSRS Funding for Military and Volunteer Retirement Benefits

The recently enacted *Postal Civil Service Retirement System Funding Reform Act of 2003* (Pub. L. 108-18) includes a provision making the Postal Service "responsible for the retirement benefits due to its CSRS enrollees as a result of prior military service" and volunteer service with such agencies as the Peace Corp, VISTA, etc. (39 USC 8348(h)(1)(B)). The Committee's report, accompanying the legislation, states that the Postal Service agreed to assume this obligation from the U.S. Treasury. (S. Rpt. 108-35 at 3). While the wisdom of this decision by the Postal Service is questionable, it is postal ratepayers that will ultimately bare the costs of this transfer.

This unique obligation transfer saddles the Postal Service with over $27 billion in additional pension benefit obligations. We concur with the Commission's report which states: "requiring Federal agencies financed through Congressional appropriations to cover the military retirement benefits of its employees still ultimately taps resources from the same appropriate revenue source—taxpayers. Requiring a self-financing Federal entity to follow suit is wholly different. It asks those who use the nation's postal system to subsidize the U.S. military every time they use the mail. . . . The Commission supports returning responsibility for this portion

of retiree benefits to the Department of the Treasury, where it resided before the recent legislation, and where this liability can be financed through funds generated by taxpayers." (Report at 126).

While the rightful return of this pension obligation to the U.S. Treasury would have budget ramifications, especially in a time of strained budgets, it will have an enormous positive impact on the Postal Service's financial position.

2. Developing an Appropriate-Sized Workforce

As the Report states, "Far more than individual benefits, the size of the workforce determines the costs of the workforce." (Report at 107). It is without doubt that the employees of the Postal Service make possible the provision of this vital national service. As Comptroller General David M. Walker's testimony states, "Only through the efforts of its workforce are more than 200 billion pieces of mail delivered, 6 days a week, to the American people." It is equally clear that as a result of the challenges facing the Postal Service the composition and size of the workforce will also need to change.

The only way for this to succeed is for the employees of the Postal Service to be seen and treated as stakeholders at the center of the reform process. As the Report notes, "Fortunately, the Postal Service will soon be presented with a unique attrition opportunity with some 47% of current career employees eligible for retirement by 2010." (Report at 175). This opportunity should allow the Postal Service to fulfill its promises to current employees while managing the size and alignment of it future workforce with minimal impact. Future cost savings realized over time will be significant.

3. Implementation of a streamlined new rate-setting mechanism

New Rate Mechanism

While the present system of ratemaking is cumbersome, costly, adversarial, and inflexible it has since 1972 enabled the Postal Service to recover in revenues 99.5% of its costs. Not a bad record. While the Postal Service and mailers, who participate as interveners in omnibus rate cases, stand to gain much through a streamlined rate-setting process, changing the current system stands to have the largest proportionate direct impact on mailers than any

recommendation in the report. This aspect of reform needs to be undertaken with extraordinary care.

The Commission did a good job of exploring new methods of rate-setting, and came to rest on the price ceiling model that is prevalent in the electricity and telecommunications sectors. The application of this model to postal rate-setting would be unique in that it involves a public entity that is not a profit seeking concern, and profit is the underlying incentive in this model. The profit incentive is what compels the regulated entity to constrain costs by seeking productivity improvements, and thus greater profits.

The price ceiling model is based on a measure of inflation (in the Report called the inflator) and a measure of productivity (the productivity factor). Without review, the regulated entity is allowed to raise rates by the difference between the inflator and the productivity factor (Inflator – Productivity Factor = Allowable rate increase). Though the Report is silent on this issue, in most circumstances the regulated entity is only allowed to raise rates without prior review on an annual basis when the inflator is updated. In addition, the inflator and productivity factor are reviewed and revised every three to five years.

While we are uneasy about losing our right to prior review by an independent regulatory body, if this regulatory scheme imposes a true revenue constraint, it could in the end make up for this loss. The escape hatch mentioned in the Report providing for rate requests in excess of the ceiling gives pause. This seems to put us back into the quasi regulatory process we now inhabit. Currently, the determinations of the Postal Rate Commission are only a recommendation and can be overruled by the regulated entity — the Postal Service.

Any escape hatch from the revenue-constraining mechanism of the price ceiling, or ability to institute serial price increases during any one year, would eviscerate the goal of "reining in spending and improv[ing] efficiency and productivity." (Report at 59).

ECSI and Cost-Based Rates for Periodicals

We are pleased that the Commission expressed its belief that "existing preferences for favorable rates for the mailing of periodicals and non-profit correspondence should be

maintained." We would add that this statement should be extended to the historical preference for all mail matter with "educational, cultural, scientific, and informational value [ESCI value]." (39 USC 3622(b)(8)).

Lastly, some in the Periodicals class, most prominently the MPA and Time Inc., have called for the introduction of cost-based rates in this class. (MPA Comments at 6). The rationale for this suggestion is that these rates would closely resemble costs to the Postal Service, and thus give further incentive for Periodicals mailers to prepare and enter their mail ostensibly reducing USPS costs of handling and distribution. While this new approach to the Periodicals rate structure may have merit it should receive a great deal of scrutiny. Many periodicals with smaller circulation sizes and dispersed subscribers are likely to be unable to avoid the penalties that a cost-based rate structure could impose on them.

I hope that the views expressed in this letter are useful to you and the Committee as it begins to formulate reform legislation. We at The McGraw-Hill Companies look forward to working with you, the Committee and other interested parties in this important process.

On behalf of The McGraw-Hill Companies,

Respectfully,

/s/ Paul A. De Giusti

Paul A. De Giusti
The McGraw-Hill Companies
Director, Government Affairs
1200 G Street, NW Ste. 1000
Washington, D.C.
(202) 383-3702
paul_degiusti@mcgraw-hill.com

Comments of the

National Association of Presort Mailers

on the

Recommendations of the President's Commission on the United States Postal Service

to the

United States Senate

Committee on Governmental Affairs

November 5, 2003

Madam Chairwoman and Members of the Committee:

The National Association of Presort Mailers ("NAPM") is a trade association representing the interests of presort mailers—i.e., mailers who presort and pre-barcode (automate) mail prior to delivery to the United States Postal Service. Members of the NAPM collectively process approximately 35 billion pieces of First-Class mail or about 2/3rds of the nearly 50 billion pieces of automated First-Class mail sent each year and a significant and growing portion of the Standard mailstream as well. In addition to submitting written testimony, representatives of the NAPM met with members of the President's Commission on the United States Postal Service, and provided oral testimony at the hearing in Los Angles. We are now pleased to present our views on the recommendations of the Commission to you and the other members of the Senate Governmental Affairs Committee. In considering our views, we hope that you will consider the fact that the presort mailing industry not only wants, but needs a strong Postal Service and that the financial and operation health of the United States Postal Service is vital to this industry.

The NAPM strongly supports 33 of the 35 recommendations of the President's Commission. We believe that these recommendations offer some hope for saving the Postal Service from meltdown cost increases in the coming years.

The NAPM is especially pleased with the Commission's strong recommendation that the Postal Service expand existing and find ways to increase worksharing between the Postal Service and the private sector. We believe that by focusing the Postal Service on the lowest combined costs of providing services to mailers through the combining of the Postal Service's strengths with the strengths of the private sector costs can be contained and the Postal Service can continue to fulfill its historic mission to bind the nation together. We believe worksharing is the most effective way to effectively "privatize" much of the work done by the U.S. Postal Service.

The NAPM also endorses strongly the proposed Postal Regulatory Board with broad regulatory authority that will: (1) focus the Postal Service on its core business and keep it out of new ventures not directly related to the delivery of hard copy mail and (2) posses the power and responsibility to protect captive mailers and enforce various restrictions or obligations imposed on the Postal Service including the authority to define the scope and nature of the universal service obligation.

The two Commission recommendations with respect to which we have reservations are Recommendations C-4 and P-4. Both deal with rate setting. The NAPM would prefer to retain the prior review process for rate setting, at least for monopoly products. In our view, the prior review process is the only method that can really provide captive (monopoly) customers with full protection from exploitation. The NAPM could, however, support reform that eliminates prior review if (1) the other recommendations of the Commission, which offer the hope that

something serious may be done about postal costs, are implemented **and** (2) the following refinement or clarifications related to rate setting recommendations are included.

1. A requirement that rates for monopoly products as well as discounts be cost based and continuation of the current prohibition on cross-class subsidies.

2. Language granting an appeal in the event that the discounts are less than the cost avoided--i.e., reciprocity. (If some parties are to have the right to appeal if discounts exceed the cost savings, then others must have reciprocal right to appeal if the discounts are less than the cost savings. This implies that discounts should be equal to the cost savings [a.k.a. the avoided costs] which is, we believe the correct approach.)

3. Language obligating, not merely empowering, the proposed Postal Regulatory Board ("PRB") to:

   a. Determine and require to the maximum extent it determines to be practical, complete transparency of and public access (with appropriate safeguards, if and when necessary) to **cost** data used to determine rates and discounts including language requiring the Postal Service to collect and publish (with appropriate safeguards if and when necessary) all the data the PRB determines are needed or that the USPS uses to determine costs, in general, and avoided costs, in particular.

   b. Proscribe the methodology to be used to calculate costs and to compute the avoided costs on which discounts are to be based.

   c. Increase in the level of cost attribution to at least 85% in twenty-five years or less.

4. Elimination of the limit on the time for the resolution of appeals, but the addition of a

60 day limit for the filing of an appeal.

5. Language:

   a. Placing the burden of proof that its rates comply with the law including all PRB requirements on the Postal Service.

   b. Providing a way to enforce, presumably via a complaint to the PRB, the recommendations that:

      (i) the Postal Service seek new and expand current opportunities for worksharing and,

      (ii) the USPS not offer products and services, other than essential postal products and services--i.e., products and services directly related to the delivery of mail, that can not be performed at a lower cost by the private sector.

   c. Prohibiting changes in the discounts absent a record showing that the avoided costs have changed-- i.e., prohibiting changes in worksharing discounts without a hearing at which the USPS demonstrates that all proposed changes are based upon changes in the costs avoided.

November 14, 2003

The Honorable Susan M. Collins
Chair
Committee on Governmental Affairs
United States Senate
304 Dirksen Senate Office Building
Washington, D.C. 20510

Dear Senator Collins:

The National Farmers Union is a general farm organization with a membership of nearly 300,000 farm and ranch families throughout the United States. Our primary goal is to sustain and strengthen farm and ranch agriculture. We believe that vibrant rural communities are vital to the health and wellbeing of the entire U.S. economy.

The strength of rural America depends on a great many factors. The policy positions advocated by the NFU encompass a wide range of issues that are important to those whose livelihoods depend on agriculture and who live in less populated regions of the United States. On behalf of our members, I appreciate this opportunity to share with the Committee our views with respect to the Report of the Presidential Commission on the U.S. Postal Service.

The Policy of the National Farmers Union, adopted in March, 2003 includes a position statement concerning the Postal Service:

> Rural America has the right to expect the U.S. Postal Service to adhere to the policy of the Postal Reorganization Act of 1971, that declares "no small post office shall be closed solely for operating at a deficit. It is the specific intent of Congress that effective postal service be assured to residents of both urban and rural communities." We oppose wholesale closings of post offices and elimination of overnight and Saturday mail delivery. We oppose the privatization of the U.S. postal system.

In light of the NFU policy position, we feel it is important to convey our concern with the Commission report and our hope that the Committee will take into account the potential adverse impacts on farm and ranch families, as it evaluates the Commission recommendations. The rural perspective was not sought in any meaningful way by the Commission and there is little evidence in the public testimony that rural concerns were addressed. This lack of attention to the agricultural community is reflected in the Commission's recommendations that the mission of the Postal Service be redefined and the scope of its services potentially curtailed

Rural America relies on accessible and dependable mail. History suggests that affordable mail service, reaching to the most remote communities of this country, was a vital factor

in the development of the rural economy. The need for that service remains as real today. The prospect of closed post offices, service reductions, and differential postal rates is an unwelcome view of the future and the NFU is vigorously opposed to going down that path.

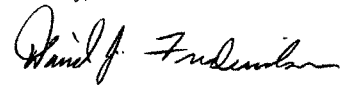
The recommendation that the 1970 Postal Reorganization Act be amended to clarify what are "essential services" and the unrestricted authority of the new Postal Regulatory Board to redefine universal service are steps to open the door to a different level of service for rural America at perhaps a different price. Mail service is essential to all Americans and it should be equally available to every citizen wherever he or she lives. Surely we are not yet at a point where the benefits Americans have come to expect such as daily mail delivery are to become a function of where you live.

Equally troublesome is the Commission's recommendation that existing statues limiting the Postal Service's flexibility with regard to the closing and disposition of post office be repealed. Current law prohibits the Postal Service from closing post offices solely on economic grounds. If the Postal Service can decide the fate of a post office strictly on the basis of revenue and without regard for the needs of the community, then the very concept of the local post office is at risk in rural America

NFU recognizes the need to ensure that the Postal Service operates in an efficient and cost effective manner and we support prudent efforts toward that end. We will not support any legislation that accomplishes cost savings at the expense of rural America and hope the Committee will reject the Commission's recommendations that foster such an outcome.

We very much appreciate your seeking the views of postal stakeholders and would welcome the opportunity to continue to share our concerns as the committee process moves forward.

Sincerely,



David J. Frederickson
President

400 North Capitol Street, N.W. - Suite 790 - Washington, D.C. 20001 - Phone (202) 554-1600

STATEMENT OF THE NATIONAL LEAGUE OF POSTMASTERS

Thank you for allowing us to submit this statement for the record of the November 5, 2003, Hearing on the Report of the Presidential Commission on the Postal Service held by the Senate Committee on Governmental Affairs. We appreciate the opportunity to make our views known.

The National League of Postmasters is a national postal management association representing the interests of Postmasters throughout the United States. Started in 1887 in Texas and formally organized in St. Louis in 1904, the League is the nation's oldest postal management group. Although the League was originally formed as the representative of rural Postmasters, today the League represents Postmasters of all types of communities. Rural Postmasters, however, still make up a sizable portion of our membership. Thus, one of the League's primary goals is to defend the sanctity of rural America and the rural post offices that bind its economic, social, and political networks together. The League speaks for thousands of retired Postmasters as well.

Although the League's purpose is to promote the rights and interests of Postmasters, we realize that we cannot do so without a strong, healthy, and viable Postal Service. To that end, the League is dedicated to seeing that intelligent, sensible, and pragmatic postal reform passes. The League's view of postal reform is legislation that recognizes the vital role that post offices play, particularly in rural America, and gives the

Postal Service the flexibility its needs to take its place among the major institutions of the 21st century.

The remainder of this Statement focuses on several recommendations that the Commission has included in its report. We should emphasize that we are still considering the ramifications of many of the Commission's recommendations, so the following should not be taken as a definitive statement of the League's position on the Commission's Report.

I. A PUBLIC INSTITUTION PROVIDING UNIVERSAL MAIL SERVICE TO THE AMERICAN PUBLIC

The League applauds the Commission for recommending that the Postal Service remain a public institution and that universal service remain the institution's primary goal. Public Service—including, most importantly, service to the mailing community—is what the Postal Service is all about, and the League strongly feels that universal service is *the* lynchpin to that public service role.

As we advised the Commission in our appearance before it, the defining public policy that has guided and governed the Postal Service from the early years of our history has been the vision of a universal mail service. That vision was founded on the notion of equal access to postal services that would connect the American people for generations to come. Equality demanded that the Post Office Department set uniform rates, so that a single stamp could get a letter from any place in America to its destination anywhere in America—whether around the block or across the country. Equality demanded that the

government provide postal services to everyone, not just the privileged and well-to-do, including rural and urban areas that some perceive as being unprofitable. The League strongly believes that we in the Postal Service should never lose that orientation, and we are pleased that the Commission agrees with us.

In focusing on universal service, the Commission also recommends that the Postal Service's mission be limited to products and services related to the delivery of letters, newspapers, magazines, advertising mail, and parcels. The League accepts that recommendation, with the caveat that the Postal Service could (and should) use its extensive network of post offices—particularly those in rural America—to provide a variety of *governmental* (as opposed to private sector) services to the public.[1] In this regard, the Postal Service's rural post offices could play a significant role in distributing government information and government products to the public (much as it has provided passport services for years) and in registering voters. Indeed, we believe that our vast network of post offices could play a vital role in Homeland Security preparedness in rural America. There is no one better positioned than rural Postmasters to act as information sources, stockpiling depots, and rallying points during a terrorist crisis in rural America.

Such a role is consistent with the Postal Service's long-standing position in rural America as the face of the federal government, should not raise the hackles of the private sector, and could add an incremental revenue stream to the Service's revenues. Fairness

[1] In considering the provision of nongovernmental services, the Commission came down squarely on the side of the Postal Service sticking to postal services and not offering a variety of "private-sector" types of services. While the League agrees with that position, it does urge the Commission not to foreclose the Postal Service from offering such ancillary services as photocopying, internet access, and other services in remote rural areas not well-served by the private sector.

would, after all, require that federal government reimburse the Postal Service for the services it would render to other government agencies.

Other government functions also could be handled through the Postal Service's infrastructure. For instance, we suggest looking into the feasibility of assisting with the administration of Medicare and federal prescription drug programs. Numerous customers in rural America already use the postal system as the main avenue for delivery of prescription drugs when there are no pharmacies nearby. Our government could also use viable post office sites as repositories for Medicare programs and/or equipment.

The League realizes that revenue from these sources probably would not amount to much in terms of the overall percentage of postal revenue, but it could easily offset a portion, and perhaps a substantial portion, of the costs of operating rural post offices. Rural post offices, after all, do not constitute a significant amount of money in the larger scheme of postal costs. As Robert Cohen of the Postal Rate Commission has indicated, the cost of maintaining the smallest 10,000 (of a total of 28,000) post offices is seven tenths of one percent (0.7%) of overall postal costs. Cohen February 2003 Testimony at 2, 9-10. This is a very small cost to pay for our rural post office network, particularily when, as is well recognized and discussed in more detail later in this Statement, the function of the Postal Service in operating rural post offices has critical ramifications that extend far beyond delivery of mail to rural areas.

II. LOOKING AHEAD TO THE FUTURE

Like the President's Commission, we do not believe that the Postal Service is in crisis, or that the sky is about to fall in on the institution, or on us. Rural America has not gone out of style. Nor is it about to. Moreover, communication by paper has not disappeared from our system. Nor is it about to. We do realize, of course, that things have to change and we pledge ourselves to that change.

The League has a vision of the Postal Service that looks to the future, that is proud of our heritage and the technological advances we have fostered, and that is not afraid of the future. Technology has been a great friend to the Postal Service in the past and has given it the flexibility to adapt to changing circumstances. We expect that to continue. The Postal Service was a leader in pioneering innovative uses for trains through sorting mail on the fly and was the leader in pioneering scheduled air travel. We fully anticipate the Postal Service to continue in that tradition, as it develops Intelligent Mail and provides new and innovative services to the mailing community, and to the world. We do not fear the future, for we realize that there will be a continued place, and an important place, for print-on-paper in that world, and thus an important place for the Postal Service.

The trick for postal management is, of course, finding that place. As we all know, the changes in electronic communications that the dawning of the 21st century has brought to us is profoundly changing the nature of the Postal Service and the nature of the

postal products we will deliver. The key to allowing the Postal Service to evolve successfully in this future, as many have correctly pointed out, is giving it the flexibility it needs to adapt to that future. The future is not something to be feared but a challenge to be met. The Postal Service will need a great deal of flexibility to do so, however, since no one can tell at this point exactly what that future will hold.

A key point—actually *the* key point—to watch as one considers the evolution of the Postal Service in the 21st Century is whether First Class mail volumes truly decline or whether they rebound.[2] There are a variety of opinions about this issue, but fortunately this is an area where opinion matters little for we all will be able to judge for ourselves in the not-too-distant future. The test will be simple—look at First Class volumes six to nine months after the economy has hit full speed. If First Class volumes are still declining, there is an enormous problem. If First Class volumes are recovering, there may still be a problem, but it will be a far more manageable one for while the Postal Service is continually adding delivery points, we do realize that the sum of those additional costs is minimal.[3].

[2] Many have looked to the current decline in First Class volumes as the harbinger of a disastrous future, since this is the first time that First Class volumes have declined since the depression. However, there is a strong argument that the Postal Service is actually doing extraordinarily well considering the triple hit on postal volume that the Postal Service has experienced in recent years because of the severity of the recent recession (which was an advertising depression), the unprecedented events of September 11, *and* the unparalleled nature of the postal anthrax crisis.

[3] The cost for the Postal Service of new delivery stops in 2003 was two-tenths of one percent (0.2%) of the total costs of the Postal Service See Testimony of Robert H. Cohen, Director, Office of Rates, Analysis and Planning, Postal Rate Commission before the President's Commission on the Postal Service, February 20, 2003 at 6 (Cohen February 2003 Testimony).

III. POSTAL PRODUCTIVITY AND RURAL POST OFFICES

While we think that the Commission's description of the postal system as a "1950s Era Postal Network" is a bit overstated, the League does understand that it is critical for the Postal Service to continue to improve productivity and that we must become more efficient. There is no doubt about that and there never has been.[4]

The Commission's report discusses the critical importance of modernizing the postal network, improving productivity, and driving inefficiency out of the system. In this vein, the Commission makes a careful distinction between post offices and postal processing facilities and suggests that the Postal Service re-optimize and realign its processing network but not close any small post offices unless they clearly have no role in providing universal service. Towards that end, the Commission recommends the creation of an independent "base-closing" type of process so that the Postal Service can re-align its system in a wholesale manner with minimal Congressional input. In making such a recommendation, the Commission clearly and distinctly limits its recommendation to the realignment of postal processing plants and does not recommend applying such a process to closing small post offices. Indeed, the Commission specifically states that the Postal Service should retain small post offices that contribute to the universal service mandate even if they "operate at a substantial loss."

Several points need be made here.

---

[4] One small step along this road would be for Headquarters to put a computer into every post office. Having a personal computer in every post office—even an "old" personal computer so long as it is capable of accessing the web—will provide the electronic framework to share quickly information with every post office, even the smallest. There really is not any good reason why, by the end of the year 2004, that any post office should lack a personal computer.

A. Problems With Determining Which Post Offices Operate At a "Loss." The first point addresses the notion of small post offices operating at a "substantial loss." The system the Postal Services uses to determine whether a post office is "making a profit" keys on the amount of revenue accepted at that post office, regardless of where the deliveries are to be completed. Thus, the postage for a hypothetical mailing of 15,000 is credited to the post office where the mailing is entered and not to the post offices where the actual pieces are delivered. That situation creates an enormous disconnect for most of the costs of delivering those 15,000 pieces are borne by the post offices of delivery (which get no revenue credit).

Thus, the system inherently skews the relationship of revenue and costs among the nation's post offices and throws into doubt much of the standard notions of what constitutes a post office operating at a loss. Consequently, while statistics in the past have shown that more than half of the post offices in the country do not "break even," this is not a true picture of the situation since the revenue is collected where mail enters the system, while the costs of delivering it are borne by the post office that ultimately delivers the piece.

B. The Cost of Operating Rural Post Offices. The second point goes to the cost of operating small post offices. The cost of operating the nation's smallest 10,000 post offices (roughly 36 percent of the total post offices in the United States) is seven tenths of one percent (0.7%) of the Postal Service's budget. Cohen February 2003 Testimony at 2, 9-10. Even if most of those post offices were closed, there would be no appreciable effect on postal finances or efficiency.

Moreover, the Commission seems to have the mistaken impression that many rural post offices are owned by the Postal Service, and thus the Postal Service could profit by selling the property. See Commission Report at 81-82. That impression is incorrect. Most rural post offices are not owned by the Postal Service but are leased. Indeed, the Postal Service has told the League it leases the vast preponderance of post offices of less than 6500 square feet.

Also, while the Commission's report makes the point that it is in the Postal Service's interest to "free" post offices of many of the retail functions, its analysis is incomplete. Indeed, while it may be advantageous for the Postal Service to remove retail sales from many post offices in crowded urban and suburban areas—so postal personnel can better "move the mail"—that is not necessarily the case in rural areas. In rural areas and in many smaller post offices where lines are minimal, the interests of the Postal Service is in getting more local residents *into* the post office so the local Postmaster can upsell services.

C. The Role of the Rural Post Office in Rural America. In considering the future of the Postal Service, Congress must not overlook rural America and the critical role the rural post office and the rural Postmaster play in it. This is a role that goes far beyond the mere delivery of mail. It is a role that goes to the essence of cultural cohesion and to what makes up the notion of "community." The rural post office is an institution that literally bind rural America together, politically, socially, and economically. It, along with the rural newspaper, constitute the framework within which rural communities

operate. To interfere with either is to interfere with the fundamental dynamics of rural communities and to risk the destruction of them.

Rural Postmasters, as the face of the federal government in rural areas, play a role that transcends the postal function. For instance, many rural Postmasters help customers with low literacy levels in a variety of ways, providing assistance in writing checks and money orders to pay bills. Many rural Postmasters address envelopes for their patrons, as well as read and explain mail to them. As such, they provide a valuable social function and have done so for centuries.

Additionally, state and federal forms are available on site, and rural Postmasters often help local citizens with these. Local post offices also provide space for community bulletin boards and post federal notices.

Rural post offices also provide safe havens for children as school bus stops. They serve as gathering places where social news is exchanged and political issues discussed, often with some heat. It is in the rural post offices that political questions are addressed, sides argued, and opinions formed. The rural post office is an icon of rural America, and neither Congress nor the Postal Service should tamper with it. This is because, as the Committee knows well, once a rural town's post office disappears, the town often shrivels up and dies.

We believe post offices fulfill a need for this segment of the population as well as provide invaluable service to these customers that one cannot measure in dollars. We

believe post offices must be measured by the service they provide to the entire nation and not be judged solely on financial considerations.

As such, we believe that the small post office closing rules represented by 39 USC § 404(b) play a vital role in the nation and should not be disturbed.

CONCLUSION

Congress has a huge task before it in terms of postal reform, and the League pledges to constructively help Congress accomplish that task. We have given our views here on the Postal Service as a public institution that provides universal service, on the role of the Postal Service in the future, and on the role of rural post offices in rural America. We have urged Congress not to change the post office closing rules.

We understand that this Committee will hold further hearings on the Commission's report early next year. We look forward to testifying at those hearings. Thank you for considering our views.

The Honorable Susan Collins
Chairwoman
Committee on Governmental Affairs
United States Senate

Dear Chairwoman Collins

My name is John V. "Skip" Maraney and I am Executive Director of the National Star Route Mail Contractors Association (the Association). We appreciate the opportunity to provide testimony to the Committee with respect to Postal Reform. The Association ultimately represents some 17,000 Highway Transportation Contracts held by small family owned businessmen and women including many minorities who transport mail over the highway and also Contractors who deliver mail to rural America. The USPS Highway Contracting Industry is the only dedicated industry with which the USPS contracts for the transportation of the mail as over 85% of our Contractors do nothing else but haul mail.

I have provided a copy of the statement of our National President, Robert B. Matheson, before the Presidential Commission on the Postal Service and my comments here will serve as an addendum to his remarks as certain other issues have emerged since his testimony.

The current law provides the USPS with the authority to contract for the transportation of the mail (Sec. 5005 (a) 4). It also provides that such contracts shall be for periods not in excess of 4 years (or if the USPS determines that special conditions or the use of special equipment warrants, not in excess of 6 years (Sec. 5005 (B) (1)). Also under the same section current law states that the USPS with the consent of the Holder of any such Contract, may adjust the compensation allowed under that contract for increased or decreased costs resulting from changed conditions occurring during the Term of the Contract. Sec. 5005 (B) (2) further states that a Contract under subsection (a) (4) of this section may be renewed at the existing rate by Mutual Agreement between the Contractor or Subcontractor and the Postal Service.

It should be pointed out that the current law does not entitle a Contractor to a renewal of his/her Contract. In fact, the courts have held that a Star-Route Contractor did not have a statutory entitlement to such renewal (See Myers & Myers Inc. V. United States Postal Service, 527 F. 2D 1252, 1254 n 2, 1257 (2nd cir. 1975). It should also be stated that a not insignificant percentage, approximately 20% of contracts are not renewed each year due to the inability to reach an agreeable rate, poor service or other reasons. Prior to 1948 the USPS had no statutory authority to renew or adjust Highway Contracts. Contracts had to be re-bid every four (4) years and the current contractor's rate was publicly posted. As a result, massive cutthroat bidding took place with Contractors just bidding to get the service with little regard to the costs necessary to operate the Contract. As a result, in 1948 approximately 48% of the Contracts throughout the United States failed due to the Contractors insufficient revenue. This event obviously had a deleterious impact on the USPS transportation network and led to the USPS and the Association to

come before Congress and request legislative authority to renew and adjust such contracts. In 1948, Congress did pass such a law (PL 669) which granted the PMG permissive authority to renew and adjust Star Route Contracts (today referred to by the USPS as Highway Contracts Routes or HCRs'). The broad language of the Law led the then Postmaster General to write to the US Comptroller General and ask for a ruling on the intent of Congress. The Comptroller General wrote back and upon reviewing the Legislative History of the Law, issued six (6) basic intents of the Law (attached for your review). So happy was the then Postmaster General to receive the above permissive authority to renew and adjust Highway Contracts that he published the Comptroller Generals Ruling on PL 669 Congressional Intent in a USPS Manual on Transportation and International Services (attached). You will note G (6) of the intent which states that the Postmaster General approach the problem of adjustments and renewals from a viewpoint sympathetic to the existing Contractor (my underlines).

Since 1948 the USPS has had a policy of renewing Highway Contractors for Successive 4 year terms as long as the Contractors price remains competitive and his/her service good, and to monetarily adjust such Contract due to changed conditions which may occur during the term of the Contract. This sound policy has worked well for the last 55 years and has provided compensating benefits to both the USPS and its Highway Contractors. The Contractor is able to amortize his/her equipment and other costs over a long period of time thus keeping his costs down and the USPS has had the continuity of service as well as good rates from professional and well-qualified Contractors. (See US Senate Committee Report 91-912, June3rd, 1970, pages 18, 19 & 20). I might add here that the USPS is a tough negotiator when it comes to negotiating contract renewal rates. It has been the culture of the USPS for the past several years that the Contractor is expected to lower his rate in order to successfully renew his Contract.

Since the 1960's when the railroads downsized operations, the USPS has depended more and more on the Highway Contractors for the transportation of its mail, both long and short hauls. In fact, the Postal Service is converting more and more of its transportation from Air and Rail over to Highway. It has determined that Highway Contractors, in most cases, offers the USPS the most efficient and economical mode of transportation. (Due certainty, celerity and security). The Highway Industry now forms a vast interdependent and interlocking transportation network. Upset any one portion of it and you may disrupt operations up and down the network. The USPS Annual Highway Contract Transportation Budget is approximately 2.5 billion. Of course, the Air and Rail Budgets are diminishing because Highway is becoming the major provider. As stated before, the USPS Highway Contracting Industry is the only dedicated mode and industry with which the USPS Contracts for its transportation.

All the foregoing having been said, the USPS and its Highway Contracting Industry is facing a dilemma of immense proportion which somehow must be mutually resolved if the USPS is to attain it's stated goal while retaining the professional services of its safety net of Highway Contractors.

The dilemma we are mutually facing is such: I know you have heard of the Postal Services Network Integration Alignment (NIA) proposals wherein it wishes to optimize its networks and in fact close and/or combine many of its facilities which it deems to be costly and unnecessary. We don't have any quarrel with the USPS on its efforts to reduce costs in these areas. In fact, the Presidents Commission on the Postal Service (PCOPS) recommended that the USPS close or combine many facilities and perhaps look at the private sector to operate others. Our mutual dilemma occurs due to the fact that there are thousands of Highway Contractors who are currently transporting mail into all the facilities in question. The issue is what happens to these transportation Contracts when the massive change of NIA takes place?

The USPS has a verbal proposal on the Table that it has discussed with the Association which, if implemented, would totally revolutionize the way the USPS currently conducts business with its Highway Contractors. The USPS position (paraphrased) is that it does not want to Contract with us for four (4) year Contracts when it knows, due to NIA, that sometime within the 4 years it may have to curtail or eliminate the Contracted Transportation and pay the indemnity due to such a Contract cancellation for convenience. Therefore, the Association has been told verbally in both a private and public meeting with Postal and Association Representatives that it wishes to, due to cost factors, implement a new Highway Contract Transportation Policy which would dictate that USPS Highway Contracts in the future be two year Flat Rate Contracts with no indemnity payments for USPS convenience cancellations, no monetary adjustments for changed conditions, and no renewals. We have requested a written copy of the USPS Plan so that we may submit written and official comments. We have been told that our request will be honored.

The Association and the Industry is most apprehensive and extremely concerned about this dramatic change in the USPS philosophy and how it plans to conduct its future business relationship with our Industry. It appears to us that with two (2) year Flat Rate Contracts with no adjustments, no indemnity and no renewals, the Highway Contract rates for such terms will have to increase dramatically as the Contractor will have to recover all his costs within a two year period in direct contrast to the current system where he/she is able to stretch costs out over a longer period of time, thus holding his Contract rate down of which the USPS is the ultimate beneficiary. The indemnity provisions in current USPS Contract General Provisions make it easier for Contractors to obtain loans from financial institutions as the indemnity allowed for a Contract cancelled for convenience of the USPS offers a measure of collateral to the Financial Institutions that the loan is protected. With no monetary adjustment for changed conditions and no renewal of the Contract, the Contractor will have to compress his costs. I again state that the current Law provides permissive authority to the USPS to renew Highway Contracts and one of the intents of the laws as ruled by the Comptroller General is "That the Postmaster General approach the problem of adjustments and renewals from a viewpoint sympathetic to the existing Contractor". Although the legal authority is permissive, it is a positive permissiveness and its clear intent is for the USPS and the Contractors to attempt to mutually renew Contracts at acceptable and competitive rates.

The Association is in current communication with the USPS (Another meeting is scheduled for January) in an on-going effort to meet the USPS needs while also attempting to protect economic investments and ensure a future with the USPS of our Contracting Industry. One thing we do know the USPS and the Contractors have an enormous challenge facing it and the USPS, in order to successfully pull off its NIA Plan is going to need the help of experienced Highway Contractors who understand and fully comply with Service Requirements demanded by the USPS. Our Contractors are professional Mail Haulers and know what it takes to accomplish the efficient movement of mail in and out of Postal Facilities. Existing Contractors must have their drivers undergo FBI checks, and be fully screened by the USPS Inspection Service, display badges when going in and out of Postal Facilities and are required to meet demanding and on-time schedules.

Postal Service Officers have told us that it's the Star Route Contractors who efficiently manage the USPS Docks. This is not the case when the USPS uses Brokers or other companies or individuals whose reputations and service is unknown to it. In too many cases the USPS does not know whom the Contractors or drivers are, that are going in and out of its facilities. As stated in President Matheson's Statement, Homeland Security could be a serious issue here as the USPS may be able to screen its Brokers but it does not necessarily know who the Broker gets to perform the service or whether these drivers have received FBI checks or have had any screening at all. This issue needs to be seriously addressed by the USPS.

In summing up, I again state that the Association and the Industry it represents is most apprehensive and extremely concerned about the USPS Plan as to how it will dictate future Contract terms and conditions in order to resolve what it sees as a major economic issue with respect to continuing to conduct business with our Industry in the traditional way we have experienced for the last 55 years. The Association feels that our Industry can compete with anyone as long as the rules are fundamentally fair and the playing field is level.

Once we receive the USPS Plan in writing, as promised, we will be providing comments and alternative proposals which hopefully can mutually resolve the USPS concerns while keeping the professional Highway Contract Industry intact. I should also mention that the USPS has also stated to us that its Box Delivery Contractors will be exempt from its proposed Plan and these Contractors will be let and renewed for four (4) years with adjustments, indemnity, etc.

As also stated in President Matheson's Statement to the PCOPS the Association supports Postal Reform and feels the USPS needs the flexibility to compete with its competitors in today's market. The economic welfare and stability of our Industry is inexorably linked to that of the USPS. With over 85% of our Contractors engaging in no other business, if the Postal Service fails or goes under so does our Industry. We need for the USPS to be economically sound and it needs us for the continued efficient and professional over-the-Highway Transportation of the mail with due certainty, celerity, and security.

On behalf of the Association I thank you for allowing me to present this testimony to you and members of the Committee. I would be happy to respond to any questions the Committee might have.

October 28, 2003

The Honorable Susan Collins
Chairwoman
Senate Governmental Affairs Committee
340 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairwoman Collins:

On behalf of the 350,000 members of the National Taxpayers Union (NTU), I write to offer our qualified support for many of the recommendations contained in the final report of the President's Commission on the United States Postal Service (USPS). As you know, NTU has long supported significant reform of the USPS, the ultimate goal of which is complete privatization of the domestic mail business. It is our belief, based on years of careful study and the success of private firms like UPS and FedEx in the package delivery business, that privatization will deliver better results, at lower costs, to American postal customers.

In the absence of more complete reform measures, many of the Postal Reform Commission's recommendations do address several long-standing issues whose resolution would improve efficiency and reduce waste at USPS. These include:

- Creation of a "Postal Network Optimization Commission" modeled on the highly successful military base closure commission, to make recommendations regarding consolidation of post offices and other USPS infrastructure. Recommendations would become final unless reversed by Congress within 45 days;

- Provision of more postal services at non-post office locations such as banks and grocery stores; this would both improve access to postal services and allow for the closure of unneeded and expensive postal facilities;

- Increased outsourcing of functions to the private sector, where work can often be performed better and at a lower cost;

- Reform of USPS's wasteful procurement rules to reflect commercial best practices;

- Bringing postal employment levels down through attrition, creating an "appropriately-sized workforce;"

- Restructuring management to eliminate redundant positions and clarify job functions;

- Voluntary compliance with Securities and Exchange Commission reporting, which would improve transparency and oversight.

108 North Alfred Street ✶ Alexandria, Virginia 22314 ✶ Telephone 703-683-5700 ✶ Fax 703-683-5722 ✶ www.ntu.org ✶ ntu@ntu.org

These steps are all thoughtful ways to move USPS in the direction of operating like a private company without actually privatizing it. Rather than a government agency with monopoly powers bestowed upon it by Congress, the best "postal reform" would be to open the market to competition. NTU offers its support for these modest measures as a first step toward more complete reform, not as a final destination for postal reform.

It is our strong hope that Congress considers implementing the aforementioned aspects of the Postal Reform Commission's report expeditiously. We look forward to working with you in the future on these and other postal reform issues.

Sincerely,

Paul Gessing

Paul J. Gessing
Director of Government Affairs

TESTIMONY OF TIMOTHY J. MAY,
GENERAL COUNSEL OF THE PARCEL SHIPPERS ASSOCIATION
ON
THE RECOMMENDATIONS OF THE PRESIDENT'S COMMISSION ON THE UNITED STATES POSTAL SERVICE
BEFORE THE
SENATE COMMITTEE ON GOVERNMENT AFFAIRS
NOVEMBER 5, 2003

The Parcel Shippers Association (PSA) is an association consisting of approximately 80 members from every section of the nation. Its members make use of Parcel Post service and Bound Printed Matter, which are parts of the Package Services class of mail. Additionally, the membership of the association makes use of First-Class Mail, including Priority Mail, and of Standard Mail. Its principal focus is the delivery of packages sold by its members to their customers.

I am Timothy J. May, a partner in the law firm of Patton Boggs LLP, and General Counsel of PSA. I was also the general counsel of the Postal Service in the period immediately preceding the successful efforts at postal reorganization. It is from that vantage point that I can testify that the problems confronting the Postal Service today are more difficult, less easily resolved, and more threatening than the circumstances that faced the Kappell Commission when it undertook the task of postal reform, beginning in 1968.

PSA is grateful for the opportunity to submit its views on the recommendations of the President's Commission on the United States Postal Service. We have carefully studied the July 2003 Report of the Commission and, as we will lay out in this testimony, we strongly support many of the Commission's recommendations for legislative and administrative reforms, and believe that the findings and recommendations of the

Commission can provide a strong foundation for the necessary restructuring by Congress of the Postal Service of the future. We are particularly pleased that the Commission has adopted recommendations that PSA urged upon the Commission. We also are pleased that much of the Commission's work and many of its recommendations seem to be in agreement with, if not based upon, the legislative efforts at reform that have taken place over the last nine years. This gives us great confidence that something can now be done to secure the future of the Postal Service since there is so much apparent agreement between and among an independent commission appointed by the President of the United States, legislation developed by the relevant committees of congress over the last nine years, and the proposals made by important stakeholders of the Postal Service.

I. THE UNIVERSAL SERVICE OBLIGATION (USO)

PSA, as part of the mail order industry, is gratified and relieved that the Commission considered and rejected the illusionary panacea of privatization; revalidated the Postal Service's current mission, including 6day delivery; recommended the continuation of the postal monopoly; and reaffirmed the need for a government sponsored postal system, providing universal service. Most important for PSA, the Commission reaffirmed package delivery services as a core part of the universal service mission.

II. GREATER FLEXIBILITY IN FIXING POSTAL PRICES AND SERVICES

PSA strongly supports the Commission's recommendation to give the Postal Service greater flexibility to meet market conditions in the fixing of postal prices and services. USPS would have the ability to establish postal rates without prior approval from the regulatory body for non competitive products within price caps established by the regulatory body.

PSA also strongly concurs in the Commission's recommendations for even greater private sector partnering and worksharing. The Postal Service is already well engaged in partnerships with the private sector where that sector can perform one or more of the mail

handling, processing, and transportation functions more efficiently than the Postal Service. In 2002, USPS rewarded mailers with $15 billion in rate discounts for worksharing. An outstanding example of worksharing is the destination delivery unit (DDU) rates. Those rates promote efficiency by combining the advantage of the lower costs of private sector parcel processing and transportation and the Service's economy of scale in delivery. This has been made possible by parcel consolidators, members of PSA, who collect parcels from shippers and consolidate them into the large volumes necessary to be able to deposit with the USPS directly at the DDU.

PSA is also pleased that the Commission has so strongly endorsed the use of negotiated service agreements (NSAs) and contract rates by the Postal Service as a means of customizing prices and services to meet the individual needs of its customers.

III. DEREGULATON OF COMPETITIVE PRODUCTS

Of paramount importance to PSA is the Commission's recommendation to deregulate totally Postal Service products that are determined to be competitive, that is, for which there is competition in the market place. At the present time, that would appear to be limited to Parcel Post and its bulk package delivery services, Priority Mail, and Express Mail. As do other mailer organizations, PSA strongly supports the Commission's recommendations that the Postal Service be given more flexibility to respond to the marketplace. That is particularly necessary for the unique situation of bulk Parcel Post package services, Priority Mail, and Express Mail.

Package delivery service is a core business of USPS. Only the Postal Service provides truly universal parcel delivery service: post office boxes; APO's; FPO's; Alaska; and Saturday delivery, just to cite some examples. USPS delivers parcels everywhere, everyday, with published and uniform tariffs. Unlike some of its competitors, it does not penalize parcel deliveries to your home with a hefty surcharge; it does not hide from, but welcomes at one of forty thousand post offices, the ordinary citizen with one package to send. The USPS parcel post service long pre-existed the entry of the United Parcel

Service (UPS) and FedEx into this market. It was and remains a vital core business of the Postal Service which must be preserved so there is some competition for parcels. Also, in order to sustain universal service, USPS must be allowed to optimize the value of its sunk network costs by competing freely in the non-monopoly competitive core services, such as parcels, even though that network may make USPS more efficient than competitors in parts of that network.

PSA strongly agrees with the Commission that bulk package services in the parcel post subclass and Priority and Express Mail should be free from regulation by the regulatory body (PRC or its successor) as to rates, classifications, service offerings, and negotiated customer service agreements

IV. RATIONALIZATION OF THE POSTAL SERVICE INFRASTRUCTURE

PSA strongly agrees with the findings and recommendations of the Commission with respect to the closure and consolidation of unneeded postal facilities. The Postal Service's own Transformation Plan also calls for that. The Commission Report very candidly addresses the political difficulties inherent in such closures. Congress will need to decide whether the Commission's suggestion for a type of base closing Commission (the PNOC Commission) will help or hinder the Postal Service in these efforts. Except for the closure of small post offices, the Postal Service already possesses the authority to close and consolidate facilities. Frankly, it is Congressional opposition engendered by local pressure groups that stand in the way of the exercise of that authority. It is a question that needs to be examined: Will a Commission whose recommendations for closure must be approved by the President of the United States, and avoid veto by Congress, create more or less opposition to closures? That is a question that the Congress itself is uniquely qualified to answer.

V. THE POWERS OF THE POSTAL REGULATORY BOARD

PSA does not disagree that under a new regime, with more ratemaking flexibility given to the Postal Service, an enhanced regulatory body will need a larger role. Nevertheless, it is our view that the powers to the Commission recommends be given to the regulatory body are excessive and, to the extent they interfere with purely management prerogatives and are broad policy making powers normally reserved to the Congress, are inappropriate. We are concerned that the proposed Postal Regulatory Board:

1. Would be given the power to redefine the universal service mission; for example, it could decree three delivery days a week, rather than 6; it could determine that the mission no longer includes the carriage of packages.

2. Would be given the power to redefine or abolish the postal monopoly; again it could do this without reference to the Congress or review by the Courts.

3. Would be given the power to devise the rules and standards under which the baseline rates and ceilings for non-competitive products will be set, with no recourse to any outside body. We believe the Congress itself needs to establish certain parameters that will guide the regulatory body in this respect.

4. Would be given the power to define what costs are attributable and to which postal products those costs are attributed. Just as troubling is the Commission's finding that more costs should be attributed than are currently attributed. Not only could this lead to fully allocated costing, the antithesis of market pricing, but under this regime the decisions of the Commission on this subject are immune from judicial review. Much of the last thirty years of ratemaking proceedings at the Postal Rate Commission have been consumed with the litigation of which costs are attributable and to which products, culminating at one point in a Supreme Court review. It is one thing to allow the Commission to be the final arbiter of attributions, as in fact it is now, where there is judicial review available

to ensure that the Commission has not abused that power; it is simply unacceptable to have a three person regulatory body make those final determinations with no review whatsoever.

Along the same lines, the Postal Regulatory Board would also be given the power to block the Postal Service from cross-subsidizing the prices it establishes for competitive products; that is fine with PSA and we understand this necessity. However, the regulatory body is also given the power to define, without review, what cross-subsidy consists of. There is a well established understanding of "cross-subsidy" in the economic literature. It may be that the Postal Regulatory Board would embrace those standard definitions; but they may very well not, and that we would object to because, again, there is no independent review. This three person regulatory body could, through fashioning its own definition of cross-subsidy, effectively render the Postal Service completely non-competitive for all of its competitive product offerings in the real marketplace.

5. Would be given the power to establish wage caps and determine wage comparability; this would effectively destroy the collective bargaining process. Basically, PSA believes that all conditions of employment should be collectively bargained for, but should be bargained for by the parties themselves without interference from outside agencies. We also believe that the collective bargaining process can be improved without undermining its very core.

6. Will not conduct trial type proceedings on any issues. Rather, they would conduct legislative type hearings where there is no opportunity to confront or have discovery upon the allegations made at those hearings. In essence, this means that there will be no evidentiary record to support the findings of the regulatory body. Because there is no judicial review of any finding or determination of the regulatory body, it becomes a moot question whether there is an evidentiary record to support its decisions.

VI. OTHER RECOMMENDATIONS

PSA also endorses these other recommendations of the Commission:

- Increased compensation for Postal Service executives
- The ability of the Postal Service to retain earnings
- Enhanced transparency of Postal Service accounts
- An Intelligent Mail program (but one which does not unnecessarily intrude upon individual privacy)

VII. ESCROW OF THE CIVIL SERVICE RETIREMENT SYSTEM (CSRS) SAVINGS AND RETIREMENT PAYMENTS FOR MILITARY SERVICE

Public Law 108-18, reforming the amount of Civil Service retirement funding required by the Postal Service, was crucial to the Postal Service's financial stability. That law, however, requires that the Congress determine, for 2006 and beyond, whether the Postal Service may expend those "savings" from reduced retirement payments or whether they will have to be kept in an escrow account unavailable for use by the Postal Service to reduce debt, to mitigate rate increases, to improve efficiency through automation, or for any other purpose. The Postal Service, as that Act required, has proposed two different alternatives for spending the "savings" if Congress will remove the escrow provisions. Either of those alternatives, or a combination of them, are reasonable uses for the "savings". PSA hopes that Congress will act upon those recommendations and abolish the escrow account; otherwise, it will obstruct the Postal Service's revenue goals and will immediately trigger higher rate increases for all users in 2006 by an additional 5.4 percent, and even larger increases in later years, according to the Postal Service.

That same law required the Postal Service, alone among all government agencies, to fund the military service component of its CSRS retirees' pension payments. We endorse the Commission's recommendation that Congress repeal that obligation, and return responsibility for this payment to the Department of the Treasury, where it belongs.

VIII. CONCLUSION

The Postal Service is not in current crisis solely because of two factors: the Postal Service has been busily engaged in reducing postal costs, carrying out its Transformation Plan, and improving productivity; and Congress, through the enactment of Civil Service Retirement Reform gave the Postal Service a substantial injection of revenues for the years 2003, 2004 and 2005. However, had not both of those factors occurred, the structural flaws of the current Postal Service business model would have brought the Postal Service to a critical and dangerous point where its mission was in peril and its dependability as an essential partner to the $900 billion mailing industry would be in great doubt. We cannot forget that looming over the Postal Service are unfunded liabilities of $92 billion. PSA urges Congress to use this breathing spell to enact basic postal reform and design a new business model for the Postal Service for the future. The blueprints are there: the report of the Presidential Commission and the substantial work done by the relevant committees of the Congress over the last 9 years. Such fundamental reform may very well take the Congress more than a year to do it right. However, those extended reform efforts should not delay the immediate enactment of the CSRS retirement changes that are needed to remove the escrow provisions from the retirement savings. Now is the time for action. What the Congress fashions may, and indeed probably will, hold the key to the survival of the Postal Service and the continued prosperity of the businesses that are totally dependent upon it, as well as the continued enjoyment of universal service by all Americans.

PSA thanks the Committee for its consideration of our views.

Respectfully submitted,

Timothy J. May
Patton Boggs LLP
2550 M Street, NW
Washington, DC 20037-1350
Counsel for Parcel Shippers Association

Dated: November, 17, 2003

Pitney Bowes
Engineering the flow of communication™

EXECUTIVE SUMMARY

Comments on the President's Commission on the U.S. Postal Service: The Need for Postal Reform

Postal Reform Now is Essential

Postal reform is essential because the Postal Service is a linchpin of the much larger mailing industry, which in turn plays a key role in our economy. The mailing industry in the United States is a $900 billion industry, with 9 million workers. It drives over 8 percent of the U.S. GDP. As such, mail is critical to commerce and the way in which the Postal Service conducts its function has a dramatic impact on American business.

Maintain Core USPS Mission and Focus

The Commission recommended that the Postal Service be structured as a publicly operated and owned entity operating with greater flexibility under a simplified regulatory framework. The Postal Service must focus on its core business, which is universal mail service – universal delivery at affordable rates. The Postal Service needs to revitalize mail as a vital communications medium by maximizing the value of mail to senders and recipients through improved service and productivity and reduced costs. The Postal Service should not enter new non-core markets that are or can be served by the private sector.

Maximize Reliance on the Private Sector

The Commission recommended maximizing use of the private sector where functions can be performed better and at lower costs. This includes expanding the use of worksharing and outsourcing. Total mail system costs can be reduced, system efficiency improved, and mail made more affordable through these partnerships with the private sector.

Aggressively Embrace Technology

The Commission recommended aggressively using Intelligent Mail (I-Mail) technology, which allows each mail piece to be uniquely identified and tracked through the use of data-rich, machine-readable information. The deployment of new mailing technologies will increase the value of mail to senders and recipients, help the Postal Service better manage its costs, and improve mail security.

Increase Pricing Flexibility

The Postal Service should be able to offer flexible pricing that depends on volume, mail mix, time of entry, desired time of delivery, or other mail preparation and service characteristics. The USPS should be allowed to offer incentives in all cases where work is transferred to customers or private intermediaries.

Civil Service Retirement System

As part of the postal reform effort, Pitney Bowes urges the Congress to approve the use of escrow funds for the benefit of the Postal Service, the $900 billion mailing industry, and the nation's economy. Otherwise, beginning in 2006, future over funding savings must be held "in escrow." Pitney Bowes agrees with the Commission that responsibility for funding the Civil Service Retirement System pension benefits related to the military service of Postal Service retirees should be returned to the Treasury to ensure equal treatment for the Postal Service.

Comments on the President's Commission on the U.S. Postal Service: The Need for Postal Reform

Introduction

Pitney Bowes appreciates the opportunity to provide comments regarding the Report of the President's Commission on the United States Postal Service. Pitney Bowes is vitally interested in postal reform, as a company, as a member of the industry, and as an American taxpayer. The Commission thoroughly examined the issues surrounding postal reform, building on earlier work by the Congress and others, and developed a blueprint for the future with workable solutions to challenges that face the Postal Service. What they and many others are calling for are dramatic, aggressive measures that will ensure a viable USPS in the 21st Century – a Postal Service that can continue providing universal service at affordable prices.

Pitney Bowes helps organizations of all sizes engineer the flow of communication to reduce costs, increase impact and enhance customer relationships. Starting in the mail and the print stream and expanding into digital documents, Pitney Bowes has developed unique capabilities for improving the efficiency and effectiveness of the communication flow critical to business.

Pitney Bowes is the world's leading provider of integrated mail and document management systems, services and solutions. Pitney Bowes invented the postage meter in 1920, which enabled the post office to offer more convenient and secure postage payment at lower cost for business mailers. Over time, our innovations created high-speed automated mail processing for large volume business mailers, and provided both conveniences for mailers who did not have easy access to a retail post office and further reductions in retail costs for the post office. Today, metered mail is 46% of the First Class mail stream and accounts for more than $24.8 billion in Postal Service revenues or about 37.5% of total revenue.

Pitney Bowes postage meters and mailing equipment are in millions of offices, small and large, across the country and around the world. We have solutions for customers that range from small home-based businesses to the largest corporations. The company's 80-plus years of technological leadership has produced many major innovations in the mailing industry and more than 3,500 active patents with applications in a variety of markets, including printing, shipping, encryption, and financial services. We also manage 1300 corporate and government mailrooms, and share our expertise every day with many thousands of additional businesses through our professional consulting services, postal management seminars, and distance learning tools for mail center managers and professionals. With approximately 33,000 employees worldwide, Pitney Bowes serves more than 2 million businesses through direct and dealer operations.

Postal Reform Now is Essential

Postal reform is essential because the Postal Service is a linchpin of the much larger mailing industry, which in turn plays a key role in our economy.

The Postal Service delivers over 200 billion pieces of mail annually, nearly 8 times that of the next largest post, and more than 40 percent of the world's letters and cards. It covers a large and dispersed geography. It is more flexible on what it accepts and processes than any other post. It would rank number 11 on the Fortune 500 List, with $69.8 billion in annual revenues and employment today of over 750,000.

Yet as large as the U.S. Postal Service is, it is only the core of a much, much larger American mailing industry. The mailing industry in the U.S. is a $900 billion industry, with 9 million workers, and it drives over 8 percent of the U.S. GDP. It ranges from printers and envelope manufacturers, to equipment manufacturers, major mailers, and mail processors.

The industry is so large because organizations understand the power of mail to exchange critical information, products, and payments. Compared with other forms of marketing, businesses and non-profits can reach out to prospects in a non-intrusive manner. Mail facilitates the collection of trillions of dollars of payments. It is the engine of remote Web-enabled commerce, for many businesses and individuals.

In short, mail is critical to commerce. It serves as a vital channel for business. We have to remember that more than 90 percent of the mail stream today is business-related. This mail is business-to-business, business-to-consumer and consumer-to-business. This is what the Postal Service refers to as "commercial mail" or "bulk mail" – mail that originates with known mailers. These mailers use meters or permits for postage. They do much of the work preparing the mail by sorting it, applying automation bar codes, and presenting the mail at designated postal facilities.

Consequently, the way in which the Postal Service conducts its function has a dramatic impact on American business. Moreover, mail is a fundamental communications tool that on its own and together with marketing and other forms of communication is an engine of growth for most businesses within and outside the mailing industry. Our vision of postal commerce includes the Postal Service as a booster of economic growth – not a drain on public resources.

Maintain Core USPS Mission and Focus

The Commission concluded that the mission of the Postal Service should be maintaining universal access and delivery at affordable prices. They endorsed a publicly owned and operated service. They recognized that what the Postal Service offers is an ever-present "final mile" delivery system. The Commission also concluded that the Postal Service should focus on its core business – accepting, collecting, sorting, transporting, and delivering physical mail.
As part of this core mission, the Postal Service needs to revitalize mail as a vital communications medium by maximizing the value of the mail to senders and recipients. This includes: improving service and productivity; reducing costs; enhancing the customer experience; and enabling the Postal Service to price its products attractively and where appropriate competitively.

Structure and Operation

The Commission concluded that the Postal Service should remain a public entity, but become leaner and more flexible. Pitney Bowes agrees with both points.

We agree with the Commission that, for the foreseeable future, a publicly-operated and owned system continues to be required to meet the needs of the American public and American business. The USPS continues to provide a fundamental service to the American people – the ability for literally everyone to send mail from anywhere to anyone, any place in the country at affordable rates. The mail system touches literally every household and business across this nation. Postal "privatization" or "liberalization" should only be undertaken cautiously and very gradually.

Some have argued that USPS privatization could be the answer to achieving higher operating efficiencies, greater market orientation, and increased agility to meet customer needs. But the potentially favorable impact of privatization needs to be weighed against the critical and immediate need that businesses and citizens have, to avail themselves of universal mail service at affordable prices. The Commission examined privatization, but concluded that it would be far too risky and would unnecessarily destabilize our universal postal service.

At the same time, we like the way the Commission addressed the issue of postal "liberalization" or the scope of the postal monopoly. The Commission endorsed the principle of gradually limiting the scope of the postal monopoly. We agree that it must be done carefully and should be directed to lowering prices and increasing services to benefit citizens, mailers and their enterprises.

We should keep in mind that the U.S. postal market in fact has been already partially "liberalized." Reliance on private-sector participation in the mail stream has often been described as the "downstream access" model of liberalization.

We also agree with the Commission that there should be a leaner USPS. This can be accomplished by right-sizing the workforce and reducing the postal network. The Postal Service can and should close redundant and underutilized processing and distribution facilities. That's what businesses have to do every day – and the productivity gains can be significant. We also like the Commission's recommendations that the Postal Service carefully contemplate end-to-end standardization of the postal network to reap large productivity gains.

The Commission noted that more than 75 percent of Postal Service revenues go to cover the cost of current and retired postal employees. As the Commission explained, far more than individual benefits, the size of the workforce determines the costs of the workforce. Once again, we agree with the Commission that enhanced productivity will enable the Postal Service to continue reducing its workforce. There is a significant attrition opportunity. Forty-seven percent of current career employees are eligible for regular retirement by 2010.

Maximize Reliance on the Private Sector

The American postal system has evolved in a climate of partnership and innovation between the public and private sectors. The United States has shown global leadership in utilizing the private sector to help the national post fulfill its functions. Pitney Bowes agrees with the Commission that these efforts must be continued and expanded. Postal operational efficiency and effectiveness will be optimized by greater reliance on private sector participation

Specifically, the Commission recommended maximizing the use of the private sector where functions can be performed better and at lower costs. Again, we agree that total mail system costs can be reduced, system efficiency improved, and mail made more affordable, through the aggressive use of worksharing, outsourcing, and partnerships with the private sector. The goal should be to reduce the total combined operational, transactional, or other costs of mail preparation, collection, sortation, and transportation. If the private sector can perform functions at lower costs, it should be encouraged to do so.

The Postal Service should give worksharing discounts whenever private sector efforts result in reduced operational, transactional, or other costs of mail preparation, collection, sortation, or transportation. Examples include pre-sorting, pre-barcoding and the drop-shipping of mail. Worksharing discounts promote economic efficiency by encouraging use of the lowest-cost provider. Estimates are that at least $15 billion in potential USPS costs have been shifted through discounts to private industry mailers and intermediaries. Without worksharing, it is estimated that there would be 187,000 more postal employees.

The Postal Service needs additional flexibility to be able to offer price incentives in all cases where this work is transferred to more efficient customers or private intermediaries. This includes savings from the application of technology by customers, such as applying postage with meters or PC Postage rather than stamps, thereby saving the significant cost of designing, producing and selling stamps. Where the application of technology results in avoided Postal Service costs, it should be recognized as worksharing and encouraged with appropriate pricing incentives.

Private sector partnership opportunities are many. They include, for example, allowing the private sector to operate Postal Service processing facilities through facility management contracts and outsourcing back office functions that are not USPS core competencies (e.g. human resources.) The goal, again, is to reduce the total combined cost of mail in whatever way possible to further enable a vibrant mailing industry.

Aggressively Embrace Technology

Technology has played an integral role in the evolution and modernization of the U.S. postal system and has saved the United States Postal Service billions of dollars. Technology will continue to be the key to a vibrant postal system. The Commission recognized this and recommended that USPS embrace technology to increase the value of mail, reduce costs, and improve security.

The technology is already available to support the next generation of mail in the form of Intelligent Mail. The Postal Service should promote Intelligent Mail or I-mail, which uses data-rich, machine-readable information to uniquely mark each mail piece. Mail can be marked to identify the postal product used, the time and place created, the payment received or required, a piece identification number and value added services as well as the sender and the recipient. I-mail enables new and valuable services, beginning with track and trace. I-mail increases the value of mail for large and small customers, enables new services, allows the USPS to better manage the mail stream and reduce postal system costs, and improves mail security.

I-mail increases the value of mail to the sender by allowing coordination with other services based on when a piece of mail is received. Knowing when the mail will arrive enables companies to time follow-up communications. For companies that receive a large number of payments through the mail, I-mail can provide crucial information on when customers have truly put the check in the mail, and can route those payments to a lockbox or other processing point for improved cash flow. Individuals could also redirect letters or packages in transit to where they might be.

I-mail reduces postal system costs. It provides the Postal Service with valuable information, to better manage its workload and its workforce, to achieve greater efficiency and reduce costs. It can help the USPS level production peaks and valleys that drive up processing and transportation costs. I-mail could enable dynamic rerouting of mail and provide data on which components of the system could be optimized.

Finally, I-mail improves security at the lowest additional cost. The traceability of "sender identified mail" deters the use of mail as a terrorist weapon because those who seek to use the mail for such purposes do so anonymously in order to evade detection. Sender Identified Mail (SIM) is mail that contains a unique identifier applied by the originator of the mail piece. SIM is one application of intelligent mail. The Postal Service recognizes that SIM can be a valuable tool in detecting and deterring attacks through the mails by ensuring traceability of mail to the sender.

We disagree with the Commission's recommendation that every piece of mail be "sender identified." Anonymous stamped mail should always remain an option for those who want it. Some have noted its importance in political discourse and whistle blowing. However, it needs to be recognized that secure, sender-identified mail is less costly and can be processed more efficiently and swiftly. Conversely, anonymous mail may incur additional security costs and take longer. For these reasons we believe the Postal Service can and should promote the creation of SIM and discourage the creation of "at risk" mail (generally anonymous stamped collection mail).

Increase Pricing Flexibility

We support the Commission's recommendation that the Postal Service be allowed to offer pricing flexibility. The Postal Service should be allowed to negotiate prescribed rates by customer, in the form of Negotiated Service Agreements or contract rates. Flexible pricing will allow greater management discretion to enter into arrangements favorable to the Postal Service,

specific customers, and the postal system as a whole. Flexible pricing will enable the Postal Service to more effectively use its capacity, resulting in lowered total average prices and increased mail volume.

In addition, we would go farther than the Commission to say that the Postal Service also should implement dynamic pricing to quickly change prices by month, day, and even time of day, much like the airlines, phone companies or hotels. This freedom to price its products will allow the Postal Service to add value, maximize volume, smooth out mail flows, reduce costs and increase revenue.

In order for the Postal Service to have the needed pricing flexibility, a fresh look at the current ratemaking process is required. Today, the USPS finds itself unable to react to changing competitive forces and customer needs with more flexible offerings for new products, variations of current products, or changes in prices that reflect its economics of production. Postal customers ultimately bear all the costs of the current ratemaking process, which can take as much as 18 months.

Price stability is also needed. As a general matter, we believe postal rates should not increase faster than the rate of inflation, and improved productivity should enable rates to increase even less.

In general, we support the Commission's recommendations for after the fact review of rate changes provided any increases are below a maximum tied to the rate of inflation.

Focus on the Core Postal Business

As mentioned earlier, Pitney Bowes supports the Commission's recommendation that the Postal Service should focus on its core business – accepting, collecting, sorting, transporting, and delivering physical mail. The USPS should be granted the commercial freedoms that will allow it to thrive and prosper in this core business in the future, but not at the detriment of existing private players or any potential private players in other non-core markets of the future. The Postal Service should not enter new non-core markets that are or can be served by the private sector.

A continuing role for the postal regulators will be to ensure a fair opportunity for all participants in the postal sector. The Postal Service should be given clear guidelines as to its regulatory role. It is not the role of a commercial operator, such as the Postal Service, to determine market share or favor particular competitors. The Postal Service should be empowered to act as a commercial operator, and except where absolutely necessary to its core mission, it should not be empowered to act as a government regulator. For example, it is inappropriate for a commercial operator to be empowered to compel the disclosure, transfer, or licensing of private sector intellectual property such as patents, copyrights and other proprietary information. Rather, its mission should include enhancing the role of the private sector to ensure a robust mail system.

Civil Service Retirement System

Earlier this year the Congress acted to correct a serious over funding situation with respect to USPS Civil Service Retirement System obligations. That action allowed the Postal Service to reduce debt by more than $6 billion and ensure rate stability until at least January 2006. Beginning in 2006, however, future over funding savings must be held "in escrow" and cannot be used by the Postal Service until approved by Congress. As part of the postal reform effort, Pitney Bowes urges the Congress to approve use of these funds for the benefit of the Postal Service, the $900 billion mailing industry, and the nation's economy. Pitney Bowes also agrees with the President's Commission that responsibility for funding Civil Service Retirement System pension benefits related to the military service of Postal Service retirees should be returned to the Department of Treasury so the Postal Service is treated the same as all other federal agencies with respect to these obligations.

Comments of the Postal Rate Commission
Concerning the President's Commission on the Postal Service
Submitted to the
Committee on Governmental Affairs

November 19, 2003

The Postal Rate Commission provides these comments to the Committee on Governmental Affairs in the hope that they will assist the Committee in developing legislation to strengthen the nation's postal system. The Committee has held hearings to evaluate the Report of the President's Commission on the Postal Service, dated July 31, 2003. That report, subtitled *Making the Tough Choices to Preserve Universal Mail Service,* identified numerous current and expected challenges facing the Postal Service, and suggested a sweeping overhaul of the nation's postal system.

The President's Commission suggests that the Postal Rate Commission (PRC) play an important role in the revamped system. It recommends that "the Postal Rate Commission should be transformed into a new Postal Regulatory Board with the responsibility to protect the public interest and promote public confidence in the fairness and transparency of postal operations." (Recommendation C-3.) The PRC wishes to assure the Committee that it fully supports efforts to improve the likelihood that the nation will continue to receive superior postal service in the coming decades, and that it stands ready to fulfill whatever role may be found appropriate and necessary to achieve that goal.

The PRC believes that the President's Commission has done an extraordinary job of synthesizing a huge amount of information from diverse sources into an understandable and persuasive call for reform. The Report is particularly timely, as recent volume trends have made the need for action clear to all those concerned with the preservation of a healthy, self-sufficient, ubiquitous Postal Service.

I. Broad Considerations

A. Historical Background

The Final Report of the President's Commission recommends the continuation of several policies that have been constants in the nation's postal system for years, such as universal service, a strong federal presence in the postal system, and certain related monopoly features. The President's Commission's endorsement of these policies provides an important bridge to the future. It also sends a strong message to the American public about the stability and strength of one of our nation's most enduring institutions.

At the same time, the Commission qualifies continuation of some of these longstanding policies by further suggestions that would, if adopted, fundamentally alter the balance the Postal Reorganization Act of 1970 struck in important areas. This may be found to be necessary and appropriate, but it warrants careful examination.

Currently, the PRC is charged with providing opinions developed in an open, public forum in which all affected interests can participate to assure that postal rates and services are consistent with the policies established by Congress, and with recommending postal rates and classifications that meet those criteria. It is also responsible for hearing appeals of certain post office closings and consolidations.

The PRC is proud of its history of promoting more efficient postal operations through rates that have encouraged worksharing with the private sector. These comments reflect the PRC's view that the current system can be, and should be, improved; but that care should be taken to assure the preservation of the Postal Service's honored tradition of binding the nation together by making affordable service readily available to all. Americans trust their Postal Service to meet their needs, regardless of geographic location or economic circumstances. This trust has been earned through decades of dedicated service, and it must not be squandered.

It is important to remember that the current system is not a bundle of freestanding provisions, but rather a unified compromise developed in the 1970 Act's intricate network of policies outlining the broad contours of our modern postal system. In some instances, such as in the area of regulation, there was wholesale adoption of

other areas of law, such as the Administrative Procedure Act. This law codifies many important safeguards the American public has come to associate with its government, such as an opportunity to be heard; fair and open hearings; and reasoned, record-based decisions. It is the basis for our operating regulations at the PRC, most notably for rate and classification proceedings.

As many years have elapsed since 1970, some might not fully appreciate that the regulatory framework the PRC and the Postal Service operate within was the product of a hard-fought compromise. The PRC firmly believes that the President's Commission has identified many essential improvements for our postal system. We also believe that public acceptance will be strongest if all affected interests again are given a "seat at the table" to express their concerns and fashion an acceptable final product that incorporates these needed changes. This Committee's commitment to further hearings and open process goes a long way to assuring broad support for legislation modernizing Postal Service business practices.

Your predecessors struggled with how to fund a federal postal system that could maintain a universal service commitment. Before reorganization, postage rates were hammered out in the halls of Congress, and some commercial mail was simply sent for free. Taxpayers picked up a large portion of the tab. The tools and time essential to developing a fair and equitable set of rates and products were simply not ready at hand. Those legislators hit upon a broad delegation of revenue-raising power to Postal Service management, the Governors, and the PRC, with judicial review as an important check. This delegation, however, was tempered with concern about the public interest. For example, the PRC currently is required to explain how its rate recommendations accommodate the value of mail service to senders and recipients, and the effect of rate increases on the general public, business mail users, and private sector enterprises that deliver parcels.

B. Safeguarding the Public Interest: Then and Now

Safeguarding the public interest is a touchstone of the 1970 Act, and finds expression in myriad policies and procedures that inform the everyday workings of the system that has been in place since 1970. "Universal mail service" is perhaps the best-

known example on everyone's short list of significant Reorganization Act policies. This concept has never been fully spelled out, although this mandate generally has come to be viewed primarily in terms of providing every physical address in the United States with some form of regular, basic postal services. The directive that "no post office shall be closed solely for running a deficit" was a means of fulfilling that goal.

Now, more than 30 years later, the President's Commission has concluded that universal service "remains vital to the nation and its economy at the dawn of the 21st century." (Executive Summary at vii.) It also recommends a new approach for closing post offices, which may entail eliminating the proviso against closing offices simply for not paying their way.

Regardless of one's position on the advisability of adopting these suggestions, it is worthwhile to remember that they, like the regulatory mechanisms mentioned above, were not freestanding provisions. Instead, they were part of the much broader, pervasive conclusion that the Postal Service should play a "nation binding" role.

The President's Commission viewed its purpose as to identify and recommend things that would further a primarily economic goal: "to ensure the efficient operation of the United States Postal Service while minimizing the financial exposure of the American taxpayers." (Forward, at iii.) It believes that a more flexible and empowered management could make great progress toward this goal. To counterbalance more independent management, the President's Commission recommends that a Postal Regulatory Board be vested with "broad authority to set the public-policy parameters within which the Postal Service is allowed to operate." The Commission emphasizes that its recommendations are contingent on a strong, independent Board with a clear mandate to protect the public interest. (Report at 53, 55, and 70.)

The Commission envisions a Postal Regulatory Board which will, among other functions, exercise broad public policy oversight to ensure that revenues from non-competitive products are not used to subsidize the provision of competitive services. This recommended duty appropriately recognizes the importance of preventing such cross-subsidies to both users of monopoly services such as First-Class Mail, and to private sector firms that should be protected from unfair competition from their government.

The Regulatory Board would also oversee Postal Service cost distribution, ensuring that it is appropriately allocating costs across its competitive and non-competitive products and services. The PRC's institutional experience confirms the importance of this analytical function. In addition to verifying that cross-subsidies between services are not occurring, such analysis is necessary for assessing the fairness of the rates the Postal Service is currently charging, or proposes to charge.

The Commission also recommends that the Regulatory Board should ensure the financial transparency of the Postal Service, obtaining information from the Service — if need be — through the use of subpoena power. Financial transparency is indispensable for two reasons: (1) it promotes public confidence in the Postal Service's business performance, and (2) it makes feasible the system of rate and other regulatory oversight recommended in the Commission's report.

Under the Commission's recommendations, the Regulatory Board would exercise two new forms of oversight regarding services the Postal Service provides. First, the Board would monitor the types of products and services offered by the Service to ensure it does not exceed its core mission. Second, the Board would review changes in service standards proposed by the Service that might have a substantial negative national impact.

The first function presumes that new legislation will clarify national policy on the appropriate areas of Postal Service business. The Postal Service's provision of "non-postal" services, and their relation to the Service's core postal functions, have given rise to vexing policy questions — and several contentious PRC proceedings — in recent years. The second function would expand a jurisdictional duty currently performed by the PRC, and would affirmatively contribute to safeguarding the public interest in preservation of the quality of services provided by the Postal Service.

The Commission further recommends that the Regulatory Board exercise public policy oversight over two fundamental features of the nation's postal system: the appropriate scope of the Postal Service's monopoly, and that of the universal service obligation. Again, these proposed functions involve issues of national postal policy appropriate for Congressional deliberation. Board oversight would assure neutral third-party review of questions on the scope of these legal obligations where legislative intent

is not clear. The Commission is to be commended for formulating an innovative regulatory approach for resolving these potentially contentious policy determinations as the Postal Service evolves in the future.

The President's Commission recommends that "the Postal Rate Commission should be transformed into a new Postal Regulatory Board with the responsibility to protect the public interest and promote public confidence in the fairness and transparency of postal operations." (Recommendation C-3.) The PRC notes that this statement of responsibility is somewhat different than the overall economic goal enunciated by the President's Commission (Forward at iii) cited above. Therefore, the PRC presents the following specific comments focusing on areas: (1) where it has particular expertise, and (2) where prospective legislation may have to consider balancing the overarching economic focus of the President's Commission Report, with providing a workable system for protecting the public interest and preserving public confidence in the Postal Service.

II. Prerequisites of Successful Postal Transformation

The President's Commission recommends that the Postal Service be transformed in several important respects to enable it to meet present and future challenges while continuing to provide affordable universal service. The Postal Service would continue to be an independent establishment within the executive branch of the Federal Government, and would retain its current monopoly over letter mail and sole access to customer mailboxes for the immediate future. The Commission further recommends that the Service be granted greater operational and pricing autonomy under enhanced regulatory oversight, while being encouraged to maximize use of outsourcing to the private sector.

The Postal Rate Commission recognizes that a variety of competing approaches have been offered — in legislative initiatives since the mid-1990s and now by the President's Commission — to adapting postal laws to the changing circumstances in which the Postal Service finds itself. Undoubtedly the Commission's recommendations and other proposals will be debated as Congress moves to consider the issue of postal reform. However, whatever specific changes may ultimately be included in legislation, the PRC views certain changes as crucial to the success of postal reform. These critical changes are identified and discussed below.

A. Financial Transparency

Among several changes intended to protect the public interest through enhancing the accountability of the Postal Service and the public-policy oversight it receives, the President's Commission recommends measures to ensure the financial transparency of the Service. It recommends that the Service voluntarily comply with pertinent Securities and Exchange Commission reporting requirements. It also recommends strong enforcement of financial transparency by a Postal Regulatory Board, in part by requiring the Postal Service to report periodically on allocation of costs among mail products and services for auditing purposes.

The Postal Rate Commission agrees wholeheartedly with these recommendations. Indeed, in our view enhanced financial transparency requirements

are essential to assuring that the Postal Service functions as a successful, performance-driven public service in the future.

The President's Commission report envisions "a healthy and efficient Postal Service that consistently operates at a high standard of excellence and delivers service quality, productivity and performance on a par with the nation's leading corporations." (Report at 36.) As the Commission also recognizes, assurance of financial transparency provides the essential framework for public confidence in the empowered, accountable managers and strong Board of Directors charged with achieving this vision. This is because timely, detailed and verifiable financial data will serve as a principal resource for documenting the Postal Service's business performance.

Furthermore, financial transparency — in the form of immediately accessible basic data about Postal Service finances and operations — will be an indispensable tool for implementing effective oversight of a transformed Postal Service.

The President's Commission recommends strong regulatory oversight performed with extreme expedition; in the case of ratemaking for non-competitive postal products, it recommends that all final determinations be rendered within 60 days. The availability of highly detailed, frequently-updated cost and other financial data are a practical imperative for conducting meaningful regulatory review of both complaints and proposed rate changes within the recommended timeframe.

B. Regulatory Oversight Commensurate with Postal Service Autonomy

The President's Commission's report concludes that: "The Postal Service's need for oversight today is as broad as the PRC's authority is narrow." (Report at 55.) On the basis of this assessment, the Commission recommends that a Postal Regulatory Board be vested with substantially expanded regulatory authority. The Board's authority would encompass not only ratemaking matters such as appropriate cost allocations, the prevention of cross-subsidies, and rate increases for non-competitive products and services, but also oversight of the appropriate scope of the postal monopoly, proposed changes to service standards, and the scope of the universal service obligation. The Board would also be tasked with ensuring the Postal Service's financial transparency, the comparability of its employee compensation to private sector benchmarks, and the

consistency of its level of accumulated retained earnings with the public interest. (Report at 56, Exhibit 4-1.)

The PRC fully agrees with the Presidential Commission's premise in this area: that the enhanced level of autonomy it recommends for the Postal Service in its future operations should be matched by a correspondingly rigorous degree of public policy oversight. Particularly in light of the Postal Service's retention of the letter and mailbox monopolies, the PRC views strong regulatory oversight as a crucial element of comprehensive postal reform. Further, in our view the successful operation of the recommended system of regulatory oversight will depend on vesting the regulator with sufficient discretion to achieve a balance between potentially competing interests and objectives.

The system of regulation recommended by the President's Commission would present challenges on several fronts. First, because the strongest form of rate regulation would apply to non-competitive services (including First-Class Mail), there would be a natural incentive to control costs by all means available — including measures that might compromise the level of service provided to users. While the President's Commission recommends that the Postal Regulatory Board be assigned jurisdiction over *proposed changes* in service standards that may have a substantial negative national impact, it does not explicitly address potential erosion in service levels that might result from cost-cutting programs. In the PRC's view, the regulator should also have authority to ensure that appropriate levels of service are maintained.

Another essential responsibility involves the recommended oversight of both the scope of the Postal Service's monopoly and that of its universal service obligation. The Commission report recommends that the Postal Regulatory Board's roles include "defining the scope of the postal monopoly, refining the appropriate components of the universal service obligation, and establishing the bright-line boundaries between the postal monopoly and competitive markets." (Report at 62.) The Commission provided sound public policy rationales for assigning these functions. (Report at 65.) However, the general criteria for defining the appropriate scope of Postal Service operations may merit further clarification before legislation is enacted.

Historically, an unstated premise of postal policy has been that the purpose of the monopoly is to assure the preservation of a satisfactory level of universal service. The PRC suggests that any legislation effecting postal reform should explicitly direct the regulatory body to consider preservation of an adequate level of universal service as the principal criterion when reviewing the scope of the postal monopoly.

Finally, the regulator's ability to perform the functions envisioned by the President's Commission will depend critically on the availability of adequately detailed data to enable informed review. This could encompass both information the Postal Service has on hand for its own operational purposes and other specialized data required for regulatory review. For this reason, it is our view that the regulator should be vested with authority not only to compel the production of information already prepared by the Postal Service (*i.e.,* subpoena power), but also to compel the collection and reporting of additional data reasonably required to perform its regulatory functions.

C. New, Streamlined Rate-Setting Process

The President's Commission charges the new Postal Regulatory Board with moving quickly to implement a new ratemaking system that would allow Postal Service managers significant flexibility to rapidly adjust rates. (Report at 57, Exhibit 4-2.) Management would be authorized to charge whatever rates it chooses for competitive products, so long as those rates are not cross-subsidized by non-competitive products.

The rates for non-competitive (monopoly and market-dominant) products also could be set at whatever level management chooses so long as they meet two tests: rates for each product must cover its costs, and rates for a product may not increase faster than an inflation-related metric established by the regulator. The first test exists today, and is well understood. The second test is new, and the Commission views it as an important incentive to make the Postal Service manage itself more efficiently.

The essential, albeit implied, tenet of this rate system is that even mailers of non-competitive products have no need to participate in a formal rate-setting process so long as their rates have not risen faster than inflation. After a "base case" rate is set for each product, rate levels for that product would be at the sole discretion of management unless rate increases exceeded increases in inflation from the date that the base case

rates took effect. Of course, as any other business, the Postal Service would maintain contacts with its customers and be expected to try to consider customer views before establishing rates.

This is a significant departure from the current system. The current system allows before-the-fact public participation to assure that rate increases are justified; requires consideration of the impact of increases on mailers, and whether the institutional burdens of the Postal Service are being fairly divided among mailers; provides for a rate decision in which the rationales for the increases are explained; and allows judicial review of arbitrary or capricious acts. None of those protections would be retained.

The Postal Regulatory Board is to establish a limit on the amount of retained earnings the Postal Service can accumulate, but so long as retained earnings do not exceed that amount, rates for each product may be increased up to the inflation-determined limit.

If the Postal Service wishes to increase rates for a product above the inflation-related ceiling, or establish rates for a new product, it would have to obtain before-the-fact authorization from the Board. The Board also is to hear complaints from mailers that contend rates are below costs, or have increased faster than inflation.

The rate case to establish the "base" rates that would serve as the benchmark for inflation-justified future increases is likely to be the most complex and contentious case ever heard by this body. It would establish relative contributions to overhead that would remain the standard for an indefinite period. Thus, participants could be expected to challenge every cost allocation and raise every policy consideration that effects rate levels. All types of mailers would be likely to consider it in their best interests to actively participate.

The President's Commission suggests that this case be processed under current PRC rate case rules. This is a sound suggestion. The Postal Service and many mailers are thoroughly familiar with these rules. Although the case would be complex, and would require extraordinary efforts by both the PRC and participants, there is no ready alternative that is more likely to produce a sound and reasoned decision in a reasonable period of time. Hopefully, the Board of Governors would be able to

schedule implementation of new rates at the beginning of a month so as to facilitate subsequent measurements of inflationary growth.

After base rates have been established, the President's Commission suggests that no major rate cases would be necessary. It proposes that all rate cases before the Postal Regulatory Board be limited to written submissions and be conducted in 60 days. The Board would then direct the Postal Service to implement whatever rate changes are found appropriate.

This system has several important virtues. It is not burdensome to either mail users or the Postal Service, and it will rapidly resolve the potential uncertainty of "proposed" rate changes. The PRC is fully prepared to face the challenges of providing available due process under this system. Nonetheless, we recognize that however well-intentioned the Board may be, it may err, and recourse through judicial review may help assure adherence to the public policies established by Congress.

Additionally, we suggest that while this process may generally be sufficient, Congress should hear from mailers whether they think this single, limited procedure is appropriate to protect their interests in all types of rate cases. It is reasonable to presume that the Postal Service will want to avoid having to request authority to raise rates above the inflationary caps. This should motivate management to restrain costs and avoid inefficient practices. However, the desire to avoid rate requests also could have unfair impacts on some mailers. The inflation-based cap on rates for each product is most fair if the costs associated with each product change together. Over the years, this has not been the case. During the last decade there were periods when Postal Service costs, in total, generally tracked inflation; however, the cost of processing certain products rose precipitously. Thus, the Service sought substantial rate increases for those products. Mailers participating in rate cases used discovery and oral cross-examination of Postal Service witnesses to identify areas where savings might be attained, and thus hold down proposed rate increases.

Should the Postal Service seek to raise rates for non-competitive mail above the inflation-based cap, there may be sound policy reasons for allowing captive customers to do more than submit written protests. The President's Commission believes that there are so many cost cutting opportunities available to the Postal Service that years

should pass before rates might have to increase above the rate of inflation. However, if this view turns out to be overly optimistic, captive mailers could be subject to repeated increases in excess of inflation with no opportunity to explore the causes of those increases.

The President's Commission seems to believe that as long as rate increases are moderate, even captive monopoly mailers have no grounds for complaint. When increases exceed the rate of inflation however, the justification for allowing postal management to impose ever-increasing burdens with only minimal user participation largely disappears.

This is not a purely theoretical problem. In a recent case (PRC Docket No. R94-1) the Postal Service proposed a rate increase of 34% for In-County publications. These mailers had been in discussions with the Service about data discrepancies before that case was filed, but without satisfactory resolution. After the Postal Service filed its request, affected mailers intervened and directed discovery to the Postal Service that forced it to acknowledge data collection errors. The Postal Service eventually altered its proposal and requested a rate reduction for this mail — but this change took place more than 60 days after the initial request was submitted. Thus, mailers may wish to comment on: (1) how much public participation should be permissible when large rate increases are involved; and (2) whether a 60-day written-submissions-only case will provide meaningful participation.

D. Hearing and Resolving Complaints

The President's Commission recommends that the Postal Regulatory Board hear and resolve a variety of complaints from the public. The Board would consider complaints that rates are unlawful either because of alleged cross-subsidy, or because rates are inconsistent with applicable ceilings. Additionally, the Commission contemplates the Board hearing complaints that the Postal Service is acting unlawfully, for example by entering a market outside the scope of its mission. (Report at 65, 68.)

Prompt action on complaints is appropriate. When cross-subsidy exists, the aphorism "justice delayed is justice denied" is applicable. The Commission foresees

that as a result of the focus on Postal Service transparency, significant amounts of data on Postal Service costs will be publicly available. The PRC agrees that this should facilitate fast action on complaints.

The Commission suggests that complaint proceedings also should be limited to written submissions. Nonetheless, it recognizes that there may be instances where a rate complaint can not be evaluated without information on actual Postal Service operations. This type of information will not be regularly reported. In such instances, the strict time limits suggested by the Commission for rate cases might prevent the evaluation of valid complaints. Therefore, it recommends that complaint cases "should be completed promptly" setting 60 days as a goal. (Report at 68.)

The Complaint process envisioned by the President's Commission supplies a substantial amount of public protection not present in the current law. The Postal Regulatory Board would be expected to promptly hear, and resolve, complaints that the Postal Service was acting contrary to public policy. Providing the Board with authority to order appropriate remedial action when a complaint is found justified, (Recommendation C-4) should substantially eliminate current concerns that the Postal Service is not held accountable for its acts.

Public protection would be strengthened even more if the complaint process suggested in the President's Commission Report were augmented by authorizing the Postal Regulatory Board to initiate proceedings whenever it has good cause to believe that existing rates are contrary to law. This might occur if rates for a product have fallen below properly allocated costs, or if Postal Service retained earnings grow to exceed applicable limits. Even with the expedited procedures recommended by the Commission, many small and medium sized mailers might not wish to commit resources to pursuing an administrative complaint. Mailers' confidence in the fairness of the system will be enhanced by the knowledge that an independent agency is authorized to initiate proceedings to assure that rates conform to statutory standards.

E. Cooperation with the Private Sector

The President's Commission extols the benefits to the Postal Service of adopting corporate best practices in all of its component operations and activities. For example,

the Commission recommends that consideration be given to using local private contractors for functions such as real estate leasing, if doing so would reduce Postal Service costs. A natural extension of this policy is allowing mailers to perform mail processing or transportation functions in return for discounted postage. Such worksharing discounts have been strongly supported by the PRC, and a considerable portion of the mail already earns worksharing discounts.

The PRC currently develops discounts through application of the economic principle of Efficient Component Pricing. This results in discounts that reflect, as nearly as practicable, costs avoided by the Postal Service. Mailers are given the opportunity to benefit from reduced postage rates when they can perform operations more cheaply than the Postal Service. Discounts developed in this way have the added virtue that they do not disadvantage either the Postal Service or other mailers.

Commission Recommendation P-4 endorses this method for constructing discounts and suggests that the Postal Regulatory Board be authorized to hear complaints that new discounts exceed avoided costs. It further suggests that the Postal Service should ensure that the expected savings from worksharing discounts are actually captured in the form of reduced costs.

The PRC suggests that it would be consistent with the goals of accountability and public policy oversight to allow the Board to hear not only complaints concerning new discounts, but also complaints alleging that changes in processing procedures, or other events, have caused existing discounts to exceed savings to the Postal Service. Additionally, public confidence that rate discounts are fair would be enhanced by making the independent regulator, as well as the Postal Service, responsible for ensuring that worksharing discounts do not exceed actual savings. This responsibility could be exercised by initiating a complaint proceeding to evaluate questionable existing discounts.

The same considerations are applicable in the area of negotiated service agreements (Recommendation P-5). The Commission suggests that the Postal Regulatory Board should develop general criteria for such agreements and conduct after-the-fact reviews if a written complaint is filed. However, public confidence in the integrity of the system would be enhanced if the independent regulator was responsible for assuring that every negotiated service agreement between mailers and the Postal Service is consistent with applicable policies, whether or not a private party files a complaint.

Printing Industries of America, Inc.

October 31, 2003

The Honorable Susan Collins
United States Senate
Washington, DC 20510

Dear Senator Collins,

I am pleased to present the following comments regarding postal reform on behalf of the members of the Printing Industries of America, Inc. We appreciate the opportunity to provide comments on a matter that is critical to the economic health of our industry.

The Printing Industries of America is the nation's largest association in the printing and graphic communications industry with over 12,000 members. These members are part of an industry that employs more than one million people and produces $155 billion in annual sales. We estimate that approximately 45 percent of printed products are sent through the mail. We also are aware that a much larger volume is designed for the mail.

We are part of a much larger communication industry that uses a variety of channels. However, for printing, the Postal Service is the primary distributor. If it fails or is forced to increase rates to an unacceptable level, our industry will also face significant problems. Our goal in postal reform is to assure that failure is avoided through sound public policy and good management.

We want to express our appreciation to President Bush for establishing the Commission on the U. S. Postal Service. We also want to acknowledge the outstanding service these men and women provided by serving on the Commission. They produced a remarkable document in a very compressed time period giving substance to the concerns that have been raised about the future of the Postal Service.

While we endorse the Commission's recommendations in general and would hope many if not all could be implemented, it is clear that not every recommendation requires congressional action.

Clearly, the most significant near-term issue for the Postal Service is to resolve the financial pressures created by the combination of the following: (1) the imbalance in the payments to the federal Civil Service Retirement System; (2) the legislation passed earlier this year requiring that future adjustments in this overpayment should be made to an escrow account; (3) the requirement that the rate payers be responsible for military retirement payments. Unless these issues, highlighted in the Commission report, can be addressed by the middle of 2004, the USPS likely cannot continue its present level of service. Likewise ratepayers will not be willing to accommodate the increases that will be necessary to offset these financial burdens.

While we understand Congressional concerns that they do not wish for the Postal Service to take advantage of a "windfall," this issue needs to be resolved in a manner that does not overly burden the mailers.

Specifically with regard to the military retiree issue, it seems completely inappropriate to require rate payers to be responsible for these payments. Retirement credits earned under the Department

100 Daingerfield Road, Alexandria, Virginia 22314-2888 703/519-8100 *fax* 703/548-3227

of Defense should be the responsibility of that agency. In this regard, it is not a matter of moving appropriations from one fund to another within the federal government. In fact, it is moving a responsibility of the federal government to a select group of companies and citizens who must use the mail.

These retirement burdens are significant and may require a longer term solution; however, a shift of these burdens to users of the mail will cripple that portion of the economy and further erode postal volume.

An additional area of legislative attention is in the management of postal facilities. It is easy to understand the public service nature of postal facilities. Likewise, it is easy to understand why local communities would appeal to their elected officials to open and maintain facilities even when they are loosing money. However, Congress needs to develop a process that will allow the USPS to manage its facilities to maximize service and minimize costs. While the "base closing commission" process proposed by the President's Commission is a tempting option, it would be better to allow the Postal Service to make these decisions with appropriate guidance, balancing service and community needs. We believe the issue of processing facilities should be within the management discretion of the Postal Service and based solely on the demands of mail volume.

One of the most important issues addressed by the Commission was the lengthy time required to consider new rates. It is important that the process be changed in a manner that would significantly reduce that time. Again, it would likely be better to enable the Postal Service to be able to adjust rates within guidelines than have to enter into a protracted process for rate changes.

We certainly welcome the positive comments from the Commission about the value of Negotiated Service Agreements and other worksharing options. These cost-savings opportunities are critical to the future of the Postal Service. Once again it would be better if the Postal Service could pursue such options without legislation. We would hope that if Congress chooses to act on these options, it would give its support.

We appreciate the opportunity to comment and would welcome the chance for further dialog.

Sincerely,

Benjamin Y. Cooper
Executive Vice President

November 14, 2003

The Honorable Susan Collins
Chair, Committee on Government Affairs
172 Russell Senate Office Building
Washington, DC 20510

Dear Senator Collins:

I'm writing to you as the result of a request I received through the Direct Marketing Association, from your staff, for information/comments from postal stakeholders on the Presidential Commission's recommendations on the USPS. I last wrote you to thank you for introducing legislation that resulted in PL108-18 which changed the way the Postal Service pensions are funded. This issue was critical to my company, Publishers Clearing House, as well as the entire direct mail industry and PL 108-18 helped to provide fair and stable postage rates through 2006. The future viability of the Postal Service is critical to the entire $900 billion direct mail industry and the outcome of the findings of the Commission will have a great impact on my business and all other businesses that use the mail as a means of communication and distribution.

Perhaps the most important comment I can make is what I don't agree with in the Commission's recommendations. The Postal Regulatory Board, as described by the Commission has far too much power and authority and virtually no one to answer to. They should not have the power to change the universal service obligation of the Postal Service or be able to determine which products are competitive and non competitive. Based on the complexity of the rate setting process, and general non-requirement of any real postal experience for appointees to this proposed regulatory board, they should have no authority over rates.

Aside from my concern about the proposed design of a new Postal Regulatory Board, I am in general agreement with most of the key recommendations of the Commission. Specifically, the recommendation to allow the Postal Service more flexibility in pricing and the ability to enter into service (rate) agreements with customers. The Commission endorses the ability for the Postal service to have contract rates (NSA's) with its customers. I fully support this concept as a tool to develop incremental mail volume and as a point of reference discounts for additional volume are not only common in private

industry but they work. The Postal Service needs the flexibility to create opportunities for its customers to grow their business thus help grow their own.

Other positive key recommendations that I support are; affirmation of package delivery as a core business, deregulation of competitive products, six day delivery, keeping the Postal monopoly and maintaining a public vs. private Postal Service.

Lastly, but perhaps most difficult is the recommendation of closing unneeded facilities. I believe that costly unnecessary and unneeded facilities are wasteful and must be closed but these closings should not inconvenience the public. I believe that this can be accomplished with some creative solutions. This is clearly a very difficult issue and the Commission does address it but their solution appears to me to be quite cumbersome and convoluted.

I think the Commission has done a fine job in a very short time in making mostly solid well thought out recommendations but can they be implemented? The difficult work lies ahead. How do we refine and make actionable these recommendations? I'm uncertain what the answers to these difficult questions are, but I offer my assistance as a resource in your efforts in this challenge. Thank you for the opportunity to offer my comments.

Sincerely,

James Bowler
Executive Director
Postal Affairs

"The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability"

U.S. Senate Committee on Governmental Affairs
The Honorable Susan Collins (R-ME), Chairman
November 5, 2003

Written Statement Submitted By:

Raymond J. Keating
Chief Economist
Small Business Survival Committee
1920 L St., NW
Washington, DC 20036
202-785-0238

Even with the dramatic changes experienced in electronic communications in recent years, timely, reliable and affordable mail and package delivery remains critical to the success of America's small businesses, and therefore, to the well being of the U.S. economy. With that in mind, the Small Business Survival Committee (SBSC), a national nonprofit, nonpartisan small business advocacy organization, welcomes the opportunity to provide written testimony on the topic of today's hearing: "The Report of the Presidential Commission on the U.S. Postal Service: Preserving Access and Affordability."

The very technological advancements — that is, the enhanced power and versatility of computers, and high-speed telecommunications (including e-mail) — that have undermined the traditional Post Office model, at the same time have empowered entrepreneurs and spurred a decentralization of our economy. Small firms, including many home-based enterprises, need affordable mail and package delivery services that they can count on to send and receive information and goods critical to operation of their businesses.

Consider that the number of businesses in the U.S. – based on Internal Revenue Service (IRS) data – jumped from 13.3 million in 1975 to 28.1 million in 2002. That's an increase of 111 percent, while the U.S. population increased by only 34 percent. We increasingly are a nation of entrepreneurs, which means there is simply more commercial correspondence taking place.

Home-based work/businesses also have been expanding at a rapid pace. According to the International Telework Association & Council, the number of self-employed individuals who work "independent of location," that is, at home, in a client's office, a satellite office, at a telework center, or on the road, at least one day a month increased by 28 percent between 1997 and 2003 – from 18.3 million to 23.4 million. A report released in 2000 from the U.S. Small Business Administration's Office of Advocacy by Joanne H. Pratt looked at 1992 data, and found that home-based businesses represent 52 percent of all sole proprietorships, partnerships and S corporations. The ability of home-based businesses to succeed, survive and thrive rests on an affordable and reliable mail and package delivery system.

Thousands of businesses are now selling goods through online auction sites. An *Entrepreneur.com* article (September 2002) noted: "You really don't need anything but a computer, an Internet connection, a printer and a digital camera." A June 2002 "eBay Live!" gathering drew 5,400 sellers, and it was reported that more than 420 million items were up for auction on eBay. Affordable shipping costs and reliability obviously are important to these enterprises.

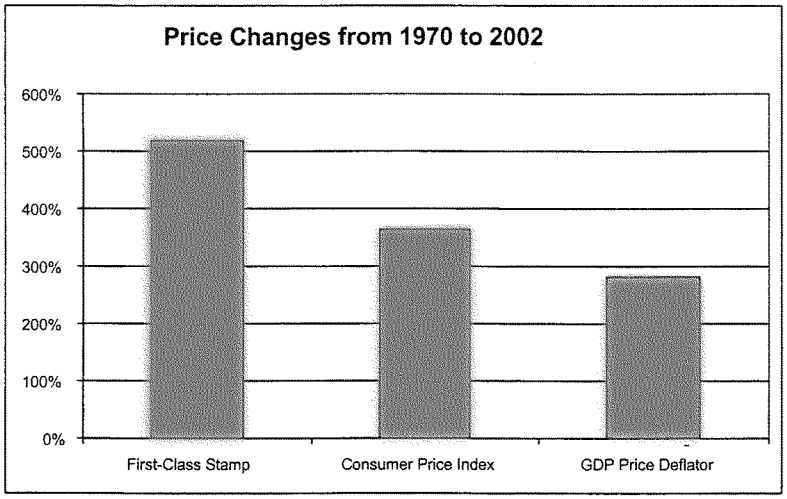
Small business dependence upon a mail and package delivery system that is reliable and affordable only heightens the importance of advancing United States Postal Service (USPS) reforms. The Postal Service faces some daunting problems – primary of

which is the fact that costs continue to balloon while revenues are projected on a downward path.

As noted above, the small business community relies greatly on the efficacy of postal services. The President's Commission drove home this point: "As individual households rely more and more on the Internet for a wider array of their communications, the nation's Postal Service -- by default -- is becoming primarily a medium for the transmission of business correspondence. All tallied, bill presentment and payment, commercial correspondence and advertising combine to generate 93% of total U.S. First-Class Mail volume today."

It's the business community that has to pay for an inefficient Postal Service.

On July 31, 2003, the Commission on the United States Postal Service delivered



its recommendations on how to fix the Postal Service to President George W. Bush. The report was titled "Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service."

There should be no doubt that the Postal Service is in desperate need of reform. The last major legislative change in how the Postal Service operates occurred in 1970. Since then, costs have risen dramatically. Consider that the price of a first-class stamp in 1970 was six cents, and had risen to 37 cents by 2002. That was an increase of 517 percent. Meanwhile, inflation over the same period as measured by the GDP price deflator, arguably the most accurate measure of inflation, registered 281 percent. Or, if one prefers to measure inflation according to the consumer price index, inflation came in

at 364 percent. As noted in the above chart, the rise in the cost of a stamp far outstripped inflation, no matter how inflation is measured.

Even with rather dramatic price increases, the Postal Service has proven unable to keep costs in line. For example, in fiscal year 2002, the Postal Service raked in almost $67 billion, but lost $677 million. That followed a $1.7 billion loss in FY2001 and a $200-million deficit in FY2000. The recent postal rate increase, plus legislation reducing the Postal Service's pension contributions, generated a surplus of roughly $4 billion for FY2003. However, losses are projected to mount ever higher in future years. For good measure, the Postal Service has some $92 billion in outstanding debt and other unfunded obligations. In its April 2002 Transformation Plan, the Postal Service acknowledged that "costs are rising faster than revenues." The bulk of those costs – "76 percent of total Postal Service expenses" in 2001 – go to labor force compensation and benefits.

In a July 2002 report ("The Postal Wage Premium: No Wonder the Postal Service Loses Money") for the Institute for Research on the Economics of Taxation (IRET), senior economist Michael Schuyler reviewed the various economics literature regarding labor force costs for the Postal Service. These studies point to Postal Service workers receiving a substantial pay premium versus comparable private-sector workers. Schuyler concluded: "A cautious estimate based on the many economic studies reviewed here is that the 'postal wage premium' is at least 20%, and more likely is 30% or more." He added: "When fringe benefits are added to cash wages, the 'postal pay premium' may be in excess of 40%."

Meanwhile, productivity gains in the Postal Service have failed to keep up with those in the private sector. In a later report ("The Postal Service's Productivity Problem," IRET, October 7, 2002), economist Schuyler observed: "According to data from the Bureau of Labor Statistics (BLS), the Postal Service increased its labor productivity (output per hour of labor) by 40% over the period 1970 to 2000, while manufacturing and private business increased their labor productivity by 149% and 74%, respectively. The Postal Service emphasizes total factor productivity, which relates output to all factors of production. The Postal Service's total factor productivity rose by 12% from 1970 to 2000. For comparison, using the roughly similar measure of multifactor productivity compiled by BLS, manufacturing and private business increased their multifactor productivity by 39% and 31%, respectively, over the same period."

The Commission's report provided some welcome and disappointing recommendations. SBSC's review of the report is highlighted below. In-depth analysis of SBSC findings are provided within a new report "The Future of the Postal Service: Did the President's Commission Deliver for Small Business?" SBSC would welcome the opportunity to provide this report to the Committee.

A seat at the table: Given that the small business, entrepreneurial sector of the U.S. economy is increasingly dependent upon an affordable, reliable mail and package delivery system, ***SBSC would like the Congress to consider dedicating at least one "small business seat" on the USPS Board of Governors***. The Commission seemed to

infer that candidates for the board should come from the world of big business and big finance. While there is no doubt that corporate CEOs as well as individuals who run large organizations and entities would add tremendous value as board members, the unique structure of the Postal Service combined with the fact that small businesses in particular require a cost-effective, reliable and mission-focused system make their input and ideas critical to the future of the institution. SBSC hopes this Committee, and the Congress, sees the value in bringing small business input and oversight to the Postal Service.

The Positives within the Commission's Report

• The Commission emphasized reducing costs in dealing with a growing imbalance between rising costs and slowing or declining revenues in the Postal Service. Note the following from the report:

> "The *rates of growth* for First-Class Mail and Standard Mail, the twin engines of Postal Service cash flow that together generate more than 75% of all postal revenues, have been in long-term decline since the 1980s. ... While some potential exists to increase revenues, ... a significant portion of the Postal Service's fiscal stabilization must come from reduced costs through the modernization of every element of its operations, service delivery and asset management."
>
> With revenue streams in retreat, "the solution clearly lies with focusing the Postal Service on its core value to the nation—delivering the mail—and recognizing that, as demand for that service contracts, perhaps the Postal Service should contract, as well."
>
> "The 1970 Act, for example, assumes perpetuation of a voluminous and archaic postal monopoly law that dates back to 1845 and is all but inscrutable in the modern context. As a result, there exists no clear boundary between the end of the postal monopoly and the beginning of the competitive postal marketplace."
>
> "While the Postal Service in recent years has explored an array of new revenue streams far afield of what most Americans consider 'postal services,' the Commission recommends that the Postal Service be restricted to products and services related to the delivery of letters, newspapers, magazines, advertising mail, and parcels."

These remarks and recommendations stand in sharp contrast to the Postal Service's desire to "grow" out of its troubles. In its April 2002 Transformation Plan, the Postal Service noted that it wants "to make use of its assets and explore service offerings in related markets."

The likely outcome of allowing the Postal Service to expand into new markets would be mounting losses and increased subsidies from either the taxpayers or ratepayers

since the Postal Service has exhibited no ability over the years to control costs. In addition, there is the issue of letting a government entity get involved in business ventures that the private sector is quite capable of performing. There is no market failure when it comes to, for example, package delivery and related business services, and therefore, no reason for government, through the Postal Service, to get involved in such ventures – other than mission creep, which often plagues government.

Many types of small businesses are impacted by the Postal Service's desire to diversify its product and service offerings. The Postal Service should not be allowed to explore business ventures outside of its core mission, period.

Compared to allowing the Postal Service to expand its mission without any economic justification whatsoever, clarifying and narrowing the Postal Service's monopoly is preferable, as are any recommendations of getting the Postal Service to focus on reducing costs.

• The Commission opens the door to private-sector provision of at least part of the Postal Service's universal service mission. For example, the report asks:

> "Does the universal service obligation require that the Postal Service *itself* carry out the core postal services expected by every American and business?"
>
> At another point, it recommends:
>
> "Where private-sector companies can perform aspects of the nation's postal service better and at less cost, the Postal Service best serves the nation by involving them in the provision of universal postal service. The Commission recommends that the Postal Service have maximum flexibility in delivering universal service by the most cost-effective, quality means available to it, including outsourcing a particular function to the private sector."

Again, it makes sense to have the Postal Service explore private sector options that could reduce costs and enhance service. Small businesses can play a big role in this regard.

The Disappointments

The Commission's report fails or falls short in other areas. A constant theme throughout this report is that the Postal Service should function like a business. However, various recommendations run counter to what businesses would do.

• The Postal Service should be able to sell to the highest bidder any of its unneeded facilities and real estate. That's an obvious benefit to consumers, as those revenues could

be used to retire debt obligations, for example. However, the Commission instead offers a political recommendation:

> "Where there is inadequate market demand for an excess post office, the Postal Service should be encouraged to transfer the facility – with or without reimbursement, as best serves the public interest – to state and local governments, as well as not-for-profit organizations."

Such giveaways amount to mere political pandering, are not sound business practices, and wind up raising costs for consumers.

• Labor costs are a huge problem, as already noted, facing the Postal Service. The Commission takes note of this. For example, it observes:

> The 1970 Act "directs compensation for Postal Service employees and officers to be 'comparable to the rates and types of compensation paid in the private sector of the economy of the United States.' Yet the statute contradicts itself by excluding pensions from collective bargaining and effectively taking retiree health benefits off the table, as well, by requiring that they be maintained at the generous levels in place when the 1970 Act became law."

Later:

> "While the clear intent of the comparability standard is to ensure wages do not lag behind the private sector, expert witnesses made the case to the Commission that a *premium* may exist today. Appearing to support these claims is the low turnover rate and the fact that new hires, on average, receive a 28.4% pay increase when they join the Postal Service." For good measure, the report pointed to health and pension benefits being far more generous than in the private sector.

The Commission noted that these cost assertions were challenged, and unfortunately decided to punt. While providing some guidelines, the Commission said that a Postal Regulatory Board should decide this matter.

Missing the Big Picture

No matter how much the Commission members might hope for or declare, the fact is the Postal Service is not a business. It is a government entity and fundamental business reforms are not possible. The Commission seems to believe it can make a governmental entity act like a private-sector business.

A private business is disciplined by owners, consumers and competition in the marketplace. Prices and costs are restrained due to competition. Owners demand performance. Profits and losses dictate success or failure. A business that cannot control

its costs and/or meet consumer demands will suffer losses, and unless improvements are made, it will go out of business. If a business does fail, then capital and labor are reallocated to more efficient and profitable ventures.

The Commission did not call for opening up the Postal Service's monopoly to competitors in the hopes that competition at least might make a difference. Instead, the Commission called for protecting, though narrowing, that monopoly.

The Commission also provides little in substance when it comes to the huge controversies of the Postal Service's special status and of monopoly profits cross-subsidizing products and services provided in competitive markets. The report notes:

> "Private carriers have no U.S. Treasury to borrow from at favorable rates, no monopoly markets to reliably generate more than 75% of operating revenues and no government exemption from most taxes and laws imposed on private enterprises. Given that distinction and the Postal Service's presence in contested markets, it has a special duty to ensure it does not wield its monopoly and government privileges unfairly against companies that have no such advantages."

The Commission's answer to these major issues was the recommendation "that the Postal Service significantly improve its cost-allocation system." The report notes that controversy swirls around the current system, especially since "40% of costs falls into this general category of institutional costs... While the Postal Service claims that significant improvements are not feasible, one leading private-sector carrier noted it had a procedure for achieving 100% cost allocation. The Commission feels that the appropriate target for the Postal Service lies somewhere in between." Again, so much for being run like a business.

The Commission also endorsed worksharing arrangements and volume discounts with entities that do a large amount of mail. Sounds reasonable, except for this controversy regarding cost allocations within the Postal Service. Without 100% proper cost allocation – as is done in the private sector – then the very real threat exists that small businesses could wind up subsidizing large corporations when it comes to mail.

While the Postal Service remains a governmental entity, there are no cure-alls to these problems – only marginal reforms. Unfortunately, the Commission rejected the only real solution, that is, privatization. The Commission asserted:

> "The Postal Service delivers more than 200 *billion* pieces of mail per year across the vast geographic expanse of the United States. Privatization of a commercial entity the size of the Postal Service could seriously disrupt both mail service and the private postal marketplace. It is highly unlikely that the private sector, acting alone, could provide the *universal* mail services we have come to expect from the Postal Service. For the Postal Service itself, privatization would likely involve a decade or more of

wrenching organizational changes that could undercut the stability and continuity that are the hallmark of public postal service."

If politics trumps economics, and the Postal Service must remain a government entity, then its mission should be constrained to the most basic notion of universal mail service. That service, though, should not be monopolized, but open to competition from private providers. Also, the Postal Service should not be allowed to venture into other areas where the private sector has proven quite capable of providing service, particularly given the Postal Service's unfair advantages when it comes to accessing a Treasury credit line, not paying taxes, and not having to live under the same laws and regulations as private firms.

SBSC thanks Chairman Collins and the Committee for providing us the opportunity to present our views on the Commission report. We look forward to working with each Committee member to ensure an affordable, reliable mail and package delivery system for U.S. small businesses.

Raymond J. Keating is chef economist for the Small Business Survival Committee.

Spencer Press Inc

90 Spencer Drive
Wells, Maine 04090
207-646-9926
Fax 207-641-8817

November 11, 2003

Susan M. Collins
United States Senate
Committee On Governmental Affairs
Washington, DC 20510-6250

Dear Senator Collins:

Thank you for your letter asking for input into postal reform. Spencer Press mails approximately 600 million mail order/retail store catalogs per year. The USPS is vitally important to our business. How and what they do has a tremendous impact on our business and that of our customers.

In the past, the USPS has raised rates with little or no regard for the overall cost of inflation. This has an adverse affect on our customers, resulting in lower print runs and in some cases the demise of their business. When financial insolvency has occurred, we the printer typically don't get paid for our work.

Your request for recommendations is very basic, run the USPS like we all run our businesses. Control costs, reduce them where possible and continue to improve service and quality. Many of the decisions may not be popular but the alternative of costs rising faster than inflation is disastrous to our industry and many others as well. The USPS must continue down the path of streamlining its operation. Automation is critical and the closing of small, ineffective post offices is a must. Every cost must be looked at and examined to see how it can be done more efficiently and cost effectively. Delivery on Saturday must be studied closely to see what the result would be if discontinued and the cost savings associated with it. Work sharing programs should also continue to be examined and implemented where possible. (We at Spencer Press deliver the majority of our mail to the SCF level within the postal system before it is considered mail.)

Those that use the postal service as their only means of distribution must have a cost that is predictable and in constant balance to all their other costs. When one is out of balance with the other, something has to give.

We as printers are willing to do whatever we can in terms of work share programs to help reduce costs. The addition of automated equipment, that would help in this process, is something we all would embrace. Working together in a partnership is beneficial to all of us.

Again, thank you for asking for our input. If there is anything we can do as a company, please do not hesitate to call upon us.

Sincerely,
Spencer Press Inc.

Stephen P. Spenlinhauer
President & C.E.O.

SPS:kam

Time Warner Inc. views on the Report of the Presidential Commission on the United States Postal Service November 6, 2003

We cannot become complacent on the issue of postal reform, which is critical to the economy, magazine readers, and the thousands of large and small American businesses that depend upon the U.S. Postal Service. As the single biggest customer of the U.S.P.S., Time Warner Inc. supports urgent action by Congress to ensure the long-term survival of America's postal system.

I. Reform Is Required – The Postal Service is at risk.

This paper presents Time Warner's views on the July 2003 report and recommendations to Congress of the President's Commission on the United States Postal Service. Time Warner, the largest single end-user of the Postal Service, is very concerned about the current and future health of the Postal Service. The success of the Postal Service is of critical importance to our company.

In April 2003, legislation was passed to correct a $78 billion overpayment of postal employee retirement costs. This legislation had a significant impact upon the finances of the Postal Service and the mailing industry making it possible for postage rates to remain stable through 2005. This will benefit the mailing industry and contribute to the nation's overall economic recovery. Our thanks and appreciation go out to those members of Congress who made this legislation a reality, particularly, Senator Susan Collins, Senator Tom Carper, Representative Tom Davis, Representative John McHugh, and Representative Henry Waxman. However, this legislation provides only temporary relief for the Postal Service and its customers, who still face significant hurdles. The need for legislative postal reform is as strong now as it was prior to the passing of CSRS legislation. The Presidential Commission's report addresses many of the issues in a reasonable, businesslike manner and merits serious consideration by Congress as new legislation is created.

First and foremost, we agree that the Postal Service is facing challenges that threaten its continued viability and place its customers at risk. Declining mail volume, diversion to electronic alternatives, escalating costs, and expanding delivery points all contribute to a dismal projection for the future unless significant action is quickly taken by Congress. We also applaud the efforts by Postmaster General Potter and Postal Service employees to remove costs from the system. But the Postal Service cannot resolve its problems merely by reducing costs. Broad and sweeping changes must occur if the Postal Service and the $900 billion mailing industry are to survive. We agree with the Commission's conclusion that a new business model is required.

II. Mission and Scope – Privatization of the Postal Service is not required. Congress must instead preserve universal service, continue six-day delivery, reinforce the lettermail monopoly, and promote cost based rates.

Any new business model must first define the organization's mission and scope. We believe that the mission of the Postal Service is to provide universal service to the American public and that this service should be provided as it is today, by a Postal Service that operates as an independent establishment within the executive branch. We do not favor privatizing the Postal Service.

Under government ownership, the Postal Service should be required to provide delivery services to every household in the United States. We also strongly support the six-day per week delivery standard, although recognize a potential future need for a reduction in delivery days if mail volumes continue to decline. We feel that Congress should revisit this issue before any change in the number of days is implemented.

To fulfil its obligation to provide universal delivery the Postal Service will need to retain the mailbox monopoly and the letter mail monopoly. We have no problem with the definition of the letter mail monopoly proposed by the President's Commission. Additionally, we believe that security of the mail is of utmost importance to consumers and the mailbox monopoly is a necessary component of mail security. We do not believe that a need exists for an independent regulator to review the scope of the letter mail or mailbox monopoly. If the monopoly needs to be re-evaluated at a future date, Congress should address the issue.

In our opinion, the Presidential Commission correctly identified the Postal Service's proper scope: "the activities of the Postal Service should be limited to: 1) accepting, collecting, sorting, transporting, and delivering letters, newspapers, magazines, advertising mail, and parcels; and 2) providing other governmental services when in the public interest and where the Postal Service is able to recover the appropriately allocated costs of providing such services."

One of the Postal Service's most successful tools to control escalating costs is worksharing, where mailers perform various functions such as pre-sorting and drop shipping. This process helps to reduce postage rates for mailers and drive costs from the postal system. Mail users must be allowed to seek the lowest combined cost between the Postal Service and other vendors. To facilitate worksharing, we have been encouraging the Postal Service to adopt "cost based rates" that reflect the actual costs of services provided. Under such a system, a mailer would select the services that it chooses to obtain from the Postal Service, such as last mile delivery, and those that it chooses to obtain from private industry, such as transporting bulk mail from a Midwestern printing facility to a USPS facility on the West Coast. This form of pricing encourages the most efficient and cost-effective process of distribution. Regardless of the regulation system that is selected, cost based rates must be at the core of the rate structure.

III. Governance – Improvements are required.

We fully support the Commission's recommendations on financial transparency and governance.

IV. Management Flexibility – The Postal Service must operate like private industry.

We agree with the majority of the Commission's recommendations in this area but have some recommendations about the scope and role of the Postal Regulatory Board, which are covered in the following section on Public Policy Oversight.

V. Public Policy Oversight – Price caps are required and the Postal Regulatory Board's proposed powers require revision.

Any business with a monopoly requires some form of oversight, especially if it is an arm of the Federal Government. Clear boundaries and limits need to be set. The Postal Service should be limited to rate increases that do not exceed CPI or some other inflation-based benchmark. Since approximately 80% of the Postal Service's costs are labor, a CPI rate cap will keep all employees whole against inflation and will allow compensation for productivity increases beyond the rate of inflation. Such a cap should be applied at the subclass level so that the Postal Service has adequate flexibility to take advantage of new worksharing opportunities within a given class of mail. The establishment of this cap should be the responsibility of Congress and not an independent regulatory body.

Under a rate cap, there should be no regulatory exception for exigent circumstances. If the Postal Service requires relief from the rate cap, it should come through Congress after a thorough and transparent review. The elimination of a provision for exigent circumstances will provide a strong incentive for the Postal Service to operate below the rate cap.

An additional boundary that must be established is the requirement that each class of mail must cover 100% of its attributable costs and make a contribution to overhead. The regulator should determine the amount of contribution for each class of mail after applying the current statutory ratemaking criteria. Time Warner is a staunch supporter of the criterion that recognizes the ECSI (Educational, Cultural, Scientific, and Informational) value provided by certain classes of mail. We feel that the existing ratemaking factors should remain a key component of the future ratemaking process. Within these boundaries, the Postal Service should be free to operate with minimal oversight regarding rates. However, we feel very strongly that this freedom must not come at the expense of service. Today, the USPS has service measurement systems for First Class, Express, and Priority mail for Periodicals, Standard, Media Mail, Library Mail, Bound Printed Matter, or Parcels. Prior to the implementation of any rate cap

system, the Postal Service must first establish service measurement systems for all mail classes.

We do not oppose the establishment of a Postal Regulatory Board with somewhat broader powers than those of the existing Postal Rate Commission, but the scope of those powers should not be as broad and sweeping as proposed in the Commission's report. A Postal Regulatory Board should perform five primary functions and should possess subpoena power over the Postal Service where necessary for the performance of these functions:

1) Enforcement of the prohibition against cross-subsidization between classes and after the fact review of all rate changes upon a complaint by consumers or mailers.
2) Review of the Postal Service's delivery standards and measurement system to ensure that rate caps are not being met at the expense of service.
3) Annual review of the Postal Service's performance incentive system to ensure that no bonuses are issued if the Postal Service fails to operate below the rate cap or meet its service standards.
4) Oversight of Postal Service accounting and reporting systems to ensure financial transparency.
5) Review of independent rate agreements such as Negotiated Service Agreements.

Several of the functions that the Commission proposed to assign to the Postal Regulatory Board should instead be established by legislation and periodically reviewed by Congress, including:

1) The scope of universal service.
2) The scope of the Postal Service monopoly.
3) The design and level of the rate cap.
4) The Postal Service's debt limit.
5) The assignment of products to the competitive and non-competitive categories.

The Commission also proposed assigning the following responsibilities to the Postal Regulatory Board that we feel should be the responsibility of the USPS Board of Directors:

1) Ensuring that Postal Service employees receive total compensation comparable to that in the private sector.
2) Ensuring that retained earnings are accumulated at a level that is appropriate and consistent with the public interest.

VI. Designing a New Postal Network – The Postal Service can improve its network without new legislation.

We believe that the Postal Service has adequate flexibility to adjust its network size and facility locations under the existing statute.
Efforts to expand access to consumers through increased use of vending machines, ATM machines, and other venues should be encouraged, although no statutory changes are

required to accomplish this. The same holds true in the areas of procurement reform, automation technology, and processing standardization. All of these initiatives are priorities for the Postal Service today and will gain importance upon the implementation of a price cap mechanism.

VII. Workforce – New legislation must address labor issues including retirement costs.

We fully support the Commission's recommendations on revisions to the collective bargaining process. Negotiators on both sides must know that today's system of binding arbitration does not always provide an optimal solution. We feel that mediation arbitration and a last best final offer will bring all parties closer to an equitable resolution while protecting the interests of the employees and Postal Service.

We also believe that "pay for performance" should be applied at all levels of the Postal Service and that employees should share in any form of bonus pool. This will provide an incentive for both the employees and management to operate under the price cap, increase productivity, and improve service.

Some of the most significant problems facing the Postal Service and mailers today are the CSRS escrow account, military pension benefits, carryover obligations, and health care benefits. Any legislation regarding the Postal Service must contain solutions to these problems. Our-proposals are:

CSRS Escrow: The escrow provision in S 380 should be repealed. This provision amounts to a stamp tax on mailers, since the CSRS liability has already been fully funded. Maintaining the escrow provision will cause postage rates to increase unnecessarily by an additional 5.4% or $40 million in the next rate case. This is entirely unreasonable. The CSRS savings should be used to instead provide an extension of rate stability until 2008.

Military Pensions: Pensions for military service should be the responsibility of the Treasury, not mailers. In essence, by having the Postal Service fulfil this obligation, mailers are being assessed a "stamp tax" to support the military. No other federal agency is saddled with this burden and neither should the Postal Service. All military pension benefits should be transferred to the Treasury for employees covered under both CSRS and FERS.

Carryover Obligations: Benefits earned by Post Office Department employees prior to the creation of the Postal Service in 1971 are the responsibility of the Federal Government, not mailers, and should be transferred to the Treasury.

Health Care Benefits: The Postal Service is facing a significant liability for retiree health care. If savings to the Postal Service result from a resolution of CSRS escrow, military pensions, and/or carryover obligations, such savings should be used first to stabilize postage rates until 2008 and second to fund the retiree health care liability. The reason we propose that rate stability take precedence over pre-funding of health care is that

mailers have been making excessive contributions to the funding of retiree benefits since 1971. Rate stabilization is necessary to bring the rates back in line with fairness. Once that is done, the health care issue definitely deserves to be the next priority.

With regard to the size of the Postal Service workforce, recent reports indicate that attrition has been a successful method to reduce labor costs. We feel that the Postal Service must use the utmost care in reducing its labor force through attrition and that no congressional action is required in this area.

VIII. Creating the Digital Postal Network – The Postal Service has the ability to improve without legislative change.

We support the Commission's recommendations in this area, but legislative changes are not required to accomplish these goals.

IX. Conclusion – Congress must take bold action to preserve the Postal Service.

Some of the urgent issues facing Postal Service and the mailing industry can be resolved under existing law, but others will require legislative change. The issues that require legislative change are not easy and involve labor law, budget scoring, and public policy oversight. The entire industry is counting on Congress to address these difficult issues in a bi-partisan effort resulting in a stronger and more stable postal system that the American people deserve. Without a strong backbone in Congress, these issues cannot be resolved and the Postal Service cannot survive. If that is allowed to happen, the negative impact upon the $900 billion mailing industry and the economy will be substantial. Time Warner is committed to working with all interested parties to achieve a successful outcome and is willing to assist Congress in any way possible to help implement urgently needed postal reform.

In summary, our top legislative priorities include:

1. **Rate increases limited to CPI.**
2. **Rates based upon costs and existing statutory ratemaking criteria.**
3. **No opportunity for exigent rate cases.**
4. **Measure service for all classes and maintain/improve service.**
5. **Reduce the proposed scope of power for the Postal Regulatory Board.**
6. **Implement a new collective bargaining process including mediation arbitration and last best offer.**
7. **Resolve retirement and health care issues.**
8. **Preservation of universal service, the lettermail monopoly, and mailbox monopoly.**

○