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ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM—PARTS I, II, AND III

HEARINGS

BEFORE THE

SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT

OF THE

COMMITTEE ON GOVERNMENT REFORM

HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

JANUARY 28, FEBRUARY 5 AND 11, 2004

Serial No. 108–135

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Available via the World Wide Web: http://www.gpo.gov/congress/house
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U.S. GOVERNMENT PRINTING OFFICE

93–087 PDF WASHINGTON : 2004

For sale by the Superintendent of Documents, U.S. Government Printing Office
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ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM—PART I

WEDNESDAY, JANUARY 28, 2004

HOUSE OF REPRESENTATIVES,
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The special panel met, pursuant to notice, at 2 p.m., in room 2154, Rayburn House Office Building, Hon. John M. McHugh (chairman of the special panel) presiding.

Present: Representatives McHugh, Burton, Schrock, Miller, Murphy, Blackburn, Davis of Illinois, Owens, Towns, Maloney and Clay.

Also present: Representatives Shays, Waxman and Tierney.

Staff present: Robert Taub, counsel; John Callender, senior counsel; Drew Crockett, deputy communications director; Teresa Austin, chief clerk; Brien Beattie, deputy clerk; Michael Layman, professional staff member; Phil Barnett, minority staff director/chief counsel; Kristin Amerling, minority deputy chief counsel; Karen Lightfoot, minority senior policy advisor and communications director; Anna Laitin, minority communications and policy assistant; Althea Gregory, minority counsel; David McMillen, Denise Wilson, and Andrew Su, minority professional staff members; Earley Green, minority chief clerk; and Cecelia Morton, minority office manager.

Mr. MCHUGH. Now here's something I haven't done. The Postal hearing will come to order. It's been about, I don't know, a few months. I feel very Freddy Kruegerish. You've seen those Nightmare on Elm Street movies. They always bury him at the end, but we manage to rise for another version, and you are part of it. So thank you for being here.

I also want to, before I begin, thank the full committee chairman and the ranking member, Mr. Tom Davis and Mr. Waxman, the gentleman from Virginia, for allowing those of us who have had no small interest in this question of postal reform to continue under the auspices of this specially-constructed panel.

And, of course, we have Mr. Davis, Danny Davis, my good friend from the great State of Illinois, who has been such a partner in this process, still on board and still pushing the issue; and to my left, your right, which is where he ought to be and should be to people's right, former chairman of the full committee, who was an absolute stalwart in postal reform and put his personal interest and his personal integrity on the line and asked to serve on this panel. So, Dan, thank you so much for being here.

I certainly want to welcome all of you back. I make light of the fact that in spite of the smart money to the contrary, we engaged in this issue again, but I think it underscores the fact that the mission we took up, while I think we did a lot of good work, remains unsolved. And as we look at our panel here today, really an excellent panel of witnesses to kick off what will be the first of three hearings that we are formally entitling "Answering the Administration's Call for Postal Reform," I think we have yet another opportunity. And let me, with that, extend a formal welcome to our panel members: Brian Roseboro, who is Acting Under Secretary at the Department of Treasury, here to talk about the administration's call for reform. And he has been joined by the chairman of the Postal Service's Board of Governors, our dear friend David Fineman; the very distinguished Postmaster General of the United States, Jack Potter; and the Postal Rate Commission chairman, no stranger to this room, to this Congress, to this Hill, George Omas; and one of the stalwarts of not just postal reform, but so many issues that transpire here on Capitol Hill, the Comptroller General of the United States, David Walker. Gentlemen, thank you all so much for being here; we appreciate it.

Before we hear from those witnesses, I would like to stress perhaps the obvious to those in this room, and that is the gravity of the matter that faces us today. The Postal Service, as I have said many, many times before, is a critical nature and critical thread in the fabric of this country. It's a nearly $900 billion industry. It employs in its total some 9 million workers nationwide and represents more than 8 percent of the gross domestic product of our Nation. Our Postal Service is in trouble and requires reform legislation to prevent a meltdown, and indeed there is good reason, in my opinion, why this administration—George W. Bush's is the first administration since President Nixon's to call on Congress to modernize our Nation's postal laws. And I remain hopeful, as I did some 8 years ago when we began this process, that as in 1970, Congress will once again in 2004 answer the President's charge.

My longstanding belief that I think is reflected by the Presidential Commission on the Postal Service's findings is that the Postal Service itself, the administration and the GAO all hold the opinion that universal service as we know it is at risk and, simply put, that reform is needed to minimize the danger of a significant taxpayer bailout or, on the converse, may substitute a dramatic postal increase. The Congress provided a bit of financial breathing room for the Postal Service last year when we reduced its payment for pension obligations, but the fundamental problems remain unchanged, and, as the President's Commission found, the Postal Service's current business model is not sustainable going into the 21st century.

Our witness testimony will make the case quite clear, I believe, but let's review some of the larger problems. First of all, under the heading of major financial liabilities and obligations, the Postal Service still faces about $90 billion in liabilities and obligations despite the passage of that pension legislation last year. Declining mail volume: In a historical first for the Postal Service, total mail volume declined last year for the third year in a row. Another unsettling milestone was achieved as first class mail volume declined

by 3.2 percent in 2003 and is projected to decline annually for the foreseeable future, and this is a very serious problem because first class mail is the bread and butter of the Postal Service, paying for more than two-thirds of its institutional costs. Under revenues, the Postal Service revenues are budgeted for zero growth in 2004, which would be the first year since postal reorganization in 1970 that postal revenues have failed to increase. However, even the zero growth target will be challenging. In the absence of revenue generated by increasing volume, the Postal Service must rely even more on rate increases. Indeed, if it weren't for the postal pension legislation of last year, ratepayers would likely be facing yet another double-digit increase in rates at the present time. And these are just the highlights of the problems, which unfortunately go on and on: changes in the mail mix, increased competition from private delivery companies, declining capital investment, insufficient increases in postal productivity, uncertain funding for emergency preparedness, and major challenges to continue cost-cutting.

While the problems are, without question, in my opinion, dire, the President's Commission and the President's subsequent articulation of principles for legislative change, I think, show us a path to some solutions. Fortunately, we have a very strong bipartisan basis upon which to proceed, including if I might define as a well-refined bill that we put together in last year's Congress, again on a bipartisan basis, largely under the leadership of Mr. Burton, the former chairman, and the ranking member, Mr. Waxman. The Postal Service is too important an institution to our economy to await the full brunt of the crisis that is clearly upon our doorstep, and as a resident of rural America, I know only too well the importance of the Postal Service's presence and operation in our daily life. And I look forward to working with my colleagues on that bipartisan basis within this committee, within this special panel, with the collaboration of our witnesses here today to respond to the President's call for action. We must preserve universal postal services at an affordable, uniform rate, and that is our challenge, and we can't fail.

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

OPENING STATEMENT
CONGRESSMAN JOHN M. McHUGH
CHAIRMAN
SPECIAL PANEL ON POSTAL REFORM & OVERSIGHT

28 JANUARY 2004

I welcome today an excellent panel of witnesses to kick off our first in a series of three hearings entitled, "Answering the Administration's Call for Postal Reform." Brian Roseboro, Acting Under Secretary at the Department of Treasury is with us to explain the Administration's call for reform, and he is joined by the Chairman of the Postal Service's Board of Governors David Fineman, the Postmaster General Jack Potter, the Postal Rate Commission Chairman George Omas, and the Comptroller General David Walker.

Before we hear from our witnesses, however, I think it is important to stress the gravity and importance of the matter that faces us today. The Postal Service is the center of a nearly $9 billion industry, employing 9 million workers nationwide, and representing more than 8 percent of the Gross Domestic Product. Our Postal Service is in trouble and requires reform legislation to prevent a meltdown. Indeed, there is a good reason why this is the first Administration since President Nixon's to call on Congress to modernize our nation's postal laws. I remain hopeful that as Congress did in 1970, we too in 2004 will answer the President's charge.

My longstanding belief, shared by the Presidential Commission on the U.S. Postal Service, the Postal Service itself, the Administration, and the GAO is that universal postal service is at risk and that reform is needed to minimize the danger of a significant taxpayer bailout or dramatic postal rate increases. The Congress provided a bit of financial breathing room for the Postal Service last year when we reduced its payments for pension obligations. But the fundamental problems remain unchanged: as the President's Commission found, *the Postal Service's current business model is not sustainable going into the 21st Century.*

Our witnesses' testimony will make the case quite clear, but let's review some of the bigger problems:

- Major financial liabilities and obligations:

The Postal Service still faces about $90 billion in liabilities and obligations despite the passage the pension bill last year.

- Declining mail volume:

In a historical first for the Postal Service, total mail volume declined last year for the third year in a row. Another unsettling milestone was achieved as First-Class mail volume declined by a record 3.2 percent in 2003 and is projected to decline annually for the foreseeable future. This is a very serious problem because First-Class mail is the bread and butter of the Postal Service, paying for more than two-thirds of its institutional costs.

- Anemic Revenue:

The Postal Service's revenues are budgeted for zero growth in 2004, which would be the first year since postal reorganization in 1970 that postal revenues have failed to increase. However, even the zero-growth target will be challenging; in the absence of revenue generated by increasing volume, the Service must rely even more on rate increases. Indeed, if it weren't for the postal pension legislation of last year, ratepayers would likely be facing yet another double-digit increase in rates.

And these are just the highlights of the problems, which go on and on and on: changes in the mail mix, increased competition from private delivery companies, declining capital investment, insufficient increases in postal productivity, uncertain funding for emergency preparedness, and major challenges to continued cost cutting.

While the problems are dire, the President's Commission and his subsequent articulation of principles for legislative change show us the path to some solutions. Fortunately, we have a strong bipartisan basis upon which to proceed, including the well-refined bill that we put together in the last Congress.

The Postal Service is too important an institution to our economy to await the full brunt of the crisis that is clearly upon our doorstep. As a resident of rural America, I know only too well the importance of the Postal Service's presence and operation in our daily life. I look forward to continuing the bipartisan work with my colleagues in the Committee, with the collaboration of our witnesses today, to respond to the President's call for action. We must preserve universal postal services. That is our challenge and we cannot fail.

Mr. MCHUGH. And again, with a word of thanks to all of our witnesses, I would be happy to yield to the ranking member, Mr. Davis, who has joined us here, for any opening comments he might have.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman, and I'm pleased to join you in opening this hearing and in welcoming our witnesses and postal stakeholders.

Before I begin my remarks, I'd like to commend Chairman Tom Davis, and Ranking Member Henry Waxman as well as yourself for the interest and willingness to work together in a bipartisan manner that all of you have shown. We began the 108th Congress on a very positive and productive note. We passed and subsequently enacted into law legislation correcting the calculation of postal payments to the Civil Service Retirement System. As consumers and members of the postal mailing community know, this change in postal pension law allowed the Postal Service to reduce its outstanding debt and hold postage rates steady until 2006. The Postal Service received a financial break and so did the public.

As we begin the second session of the 108th Congress, we have additional work to do. First, because we created an escrow account in the postal pension law, the Postal Service must provide us a workable plan on its capital investments for productivity gains and cost-saving initiatives. We are expecting additional planning information in this area by the end of the month. This effort on behalf of the Postal Service to provide us with greater detail is critical if we are to address the escrow requirement as part of postal reform legislation. As for postal reform efforts, we are moving at a positive pace, picking up on a much more positive note than where we left off in the 107th Congress. Using your postal reform bill, H.R. 4970, as a starting point, we are working on establishing a strong foundation for reform. To date our staffs have met with several postal stakeholders to solicit their recommendations for positive changes. In addition to the recommendations submitted by the President's Commission on the Postal Service in July 2003, the administration's principles for postal reform are critical to the process. The Senate, too, is engaged. Senator Susan Collins, Chair of the Senate Governmental Affairs Committee, began holding hearings last year on recommendations of the Presidential Commission on the Postal Service. Additional hearings will be held next week. To put it succinctly, we are on a mission and working together to achieve a common goal; that is, changing the laws governing the Postal Service so that it is fully prepared and capable of thriving in the 21st century.

Mr. Chairman, again, I would like to acknowledge the hard work of those in the postal mailing community, postal labor unions, nonprofits, mailers, postmasters, printers and consolidators, newspapers, banks, credit card companies, greeting card companies, magazines, catalog merchandisers, and a host of others. Their continued support and input is important as all of us work cooperatively to strengthen the Postal Service. I thank you very much and yield back the balance of my time.

Mr. MCHUGH. I thank the gentleman not just for his comments and his presence here today, but for his hard work and for his devotion to this issue.

Next, as I mentioned, someone to whom we all owe a debt of gratitude for his leadership, for his commitment on this issue, particularly during his time, 6 years, as chairman, the gentleman from Indiana, the Honorable Dan Burton. Dan.

Mr. BURTON. Thank you Mr. Chairman. First of all, I want to thank you for all the hard work you've put forth on this effort over the last 6 or 7 years. I don't think anybody's more knowledgeable about the problem than Chairman McHugh, and I really appreciate his hard work. When I was chairman, he was the point person on this issue, and we worked very hard for a long time to get a postal reform bill passed. We worked with the Postmaster and a number of you other folks to get the job done. Unfortunately, there were a number of different interests that had differing views and it ended up we tried to get the bill passed, and we couldn't. But now we're facing a much more difficult situation than we faced even then in that, according to the President's Commission on Postal Service, they are estimating the unfunded postal obligations at $90 billion. And when you say meltdown, Mr. Chairman, boy, you're not kidding.

Something has to be done, and I don't know how we are going to get the various entities to see eye to eye on a final bill, but somehow it's got to be done because a meltdown is inevitable. And we add to that the fact that more and more businesses and industry are going to e-mails and faxes, thus taking away an awful lot of revenue from the Postal Service. It only complicates the problem further.

So this is a very, very difficult problem. I don't envy you your position as chairman and trying to come up with legislation that will meet everybody's views, but it is something that I think has to be done. Otherwise we are going to have another huge government bailout, and it won't be a one-time thing.

And so this is a major problem, and I hope all of the people on the panel—I know they will—I know all the people on the panel and the people in the interested industries will work together to try to help us draft a bill that we can get passed through the Congress that will preserve the postal system, make it more workable, and thus not face a huge taxpayer bailout now and in the future.

And with that, Mr. Chairman, thank you very much.

Mr. MCHUGH. I thank the gentleman, and thank him again for his interest and participation.

I don't want to presume the order of speaking and the normal rules as to my friends on this side. I was going to offer the opportunity to the ranking member of the committee to speak, but he's graciously deferred to his colleagues who were in attendance first. So I am happy to yield to a fellow New Yorker, the gentleman from New York, of course, Ed Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman. Let me thank Ranking Member Waxman, of course Chairman Davis, and also you, Mr. Chairman, for all the work you've done on this issue and also for holding this hearing on reforming the U.S. Postal Service.

This is likely one of the most important series of hearings our committee will hold this year. Our decision will also affect the jobs of thousands of workers in the Postal Service and millions more connected to it, and that is something that we should never, never

forget. While there may be significant disagreement over the recommendations made by the President's Commission, I think it is critical that we all agree and recognize that some change needs to be made.

The Postal Service is on a course that is economically unsustainable. Each year the Postal Service adds 1.7 million new homes, businesses or other new delivery points; however, at the same time, volume has been declining for 3 straight years. While some of that decrease is due to the recent economic recession and the anthrax incidents, a portion of the decline in mail volume is due to structural changes that are only going to become more pronounced. I'm talking about e-mail, fax transmission, cell phones without distance charges have become substitutes for written correspondence. The Internet is also becoming an increasingly popular alternative for financial billing and payment. As residents and companies continue to take advantage of electronic options to communicate or make transactions, mail volume will drop. Overall, the Postal Service has lost $2.3 billion, that's "B" as in boy, in the last 3 years. We have bought some time by passing the Civil Service Retirement System Funding Act, which saved more than $6 billion for the last 2 years, but we cannot allow this breathing room to deter us from making important but tough decisions. Usually, a crisis needs to be at hand to make such choices. I hope we do not wait that long on this one.

Finally, Mr. Chairman, I would like to make one last point about the Commission's recommendations, which I think is critical. As we review the difficult choices ahead, I believe that the recommendation to preserve the Postal Service as an entity of the Federal Government that continues to provide universal service is of utmost importance and should be a lens through which we view possible solutions. The Commission said that privatization of the Postal Service was too risky and could disrupt universal service, so I think it is critical to remember as we consider possible changes to the institution that the Postal Service is not a private company, but an institution that holds a place of special public trust, and I think that's the thing that we need to keep in mind as we continue to deliberate. On that note I yield back.

Mr. MCHUGH. I thank the gentleman for his comments and for his obvious interest in this issue.

Just as a matter of procedure, and as I'm sure the gentleman from Connecticut is aware, my friend Mr. Shays, the policy is to allow the members of the panel to speak, and thereafter Members who are not a member are welcome. And we are thankful that they have an interest in this issue.

So with that I would be happy to yield to one of the newer members of the full committee, not one of the newer members of the panel because she's been on it since its beginning, but someone who has sought out this position, this challenge, and we are very grateful for that, the gentlelady from Tennessee, Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman. I have no opening statement, but I do have a list of questions, so I will yield back my time and look forward to the questioning. Thank you, sir.

Mr. MCHUGH. Best speech so far, Marsha. I like that very much. Thank you.

Next I am happy to yield to the gentleman from Missouri I believe is next, Mr. Clay.

Mr. CLAY. Thank you. Thank you for yielding, Mr. Chairman. I would like to thank you and Ranking Member Waxman for the opportunity to participate in this important discussion on congressional postal reform activity. The U.S. Postal Service represents a mainstay of American culture and commerce. It is almost inconceivable to think that in the future universal service could be diminished or that small post offices would be closed.

Reform means change, and the beginning of that change came last year with the passage of the Civil Service Retirement System Funding Reform Act of 2003. As a result, the Postal Service experienced some immediate financial relief, particularly in the area of pension savings funds. However, there are still many challenges ahead in order to bring the Postal Service up to a healthy financial position. Hopefully these hearings will bring us closer to understanding and accomplishing that goal.

Finally, I would be remiss if I did not mention the fact that I have a deep concern for the women and men who perform the Postal Service function. I want to make it clear that their concerns are my concerns. That means opposing any changes that would deny postal employees the right to engage in free collective bargaining.

Mr. Chairman, I look forward to hearing from today's witnesses and ask unanimous consent to submit my statement into the record. Thank you.

Mr. MCHUGH. Without objection, so ordered.

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

Statement of the Honorable William Lacy Clay
Before the
Government Reform Committee
Special Panel on Postal Reform and Oversight
Wednesday, January 28, 2004

"Answering the Administration's Call for Postal Reform – Part 1"

Thank you for yielding Mr. Chairman, I would like to thank you and Ranking Member Waxman for the opportunity to participate in this important discussion on Congressional postal reform activities. The United States Postal Service represents a main stay of American cultural and commerce. It is almost inconceivable to think that in the future, universal service could be diminished or that small post offices would be closed. Reform means change and the beginning of that change came last year with the passage of the Civil Service Retirement System Funding Reform Act of 2003, Public Law 108-18. As a result, the Postal Service experienced some immediate financial relief particularly in the area of pension savings funds. However, there are still many challenges ahead in order to bring the Postal Service up to a healthy financial position. Hopefully, these hearings will bring us closer to understanding and accomplishing that goal.

Finally, I would be remised if I did not mention the fact that I have a deep concern for the women and men who perform the Postal Service function. I want to make it clear that their concerns are my concerns. That means opposing any changes that would deny postal employees the right to engage in free collective bargaining. Mr. Chairman, I look forward to hearing from today's witnesses and ask unanimous consent to submit my statement into the record.

Mr. MCHUGH. I have to ask the gentleman, did your father help you write that?

Mr. CLAY. No. And he doesn't work for me.

Mr. MCHUGH. I have no doubt you work for him. That's an awkward way of saying we are honored to have the President—the presence of former Chair of the Post Office and Civil Service Committee in the House, Bill Clay, who is also somewhat related to the gentleman who just spoke. Bill, good to see you. Thanks for being here.

Next is the gentlelady from New York. Another New Yorker; I love it. Mrs. Maloney.

Mrs. MALONEY. Thank you, Chairman McHugh. And I really want to compliment you and Ranking Member Waxman and Danny Davis because you have really worked relentlessly on postal reform. And as one who represents upstate New York in many areas, there are more bears than people, but we have our post offices there, and we can get our mail up there, and so I know you have a vested interest in making sure that the services are there for the people.

And we are here basically to review the report, the President's Commission report on the U.S. Postal Service. And it contained a number of principles that a number of people concerned about this support, obviously best practices, transparency, flexibility, collective bargaining, accountability, and self-financing.

I do want to note the heroic work of postal workers in my district that I'm honored to represent during the terrible anthrax emergency. But we do need to do something because the Postal Service is facing billions of dollars in debt. They are in billions of dollars in debt and over the next few years, and the GAO—with them listing it on their high-risk list, postal reform is one of the most pressing issues we will address this year, and it will literally affect all of our constituents.

I also, in addition to representing many postal workers, I represent much of the magazine industry. I represent Madison Avenue, and the magazine industry is enormously important both for the economy of New York and really, I would say, the economy of our country in general, and magazines and mailers are an essential part of our culture; they educate us, they entertain us, they are a part of our life. But I want to note that high costs have forced many magazines that I represent out of business in the last 2 years, including Mademoiselle, Mode, Brill's Content, and the Industry Standard, to name four, leaving these workers without jobs and really affecting our economy. So at a time when millions of Americans are out of work, we should protect the jobs of everyone who relies on the Postal Service for their employment.

We need postal rates that are as low as possible, and I understand the importance of keeping rates affordable so that publishers, individuals and industries can continue to use the Postal Service. Any postal reform must take a balanced approach that considers the needs of everyone who depends on the Postal Service. All customers deserve the best service possible, and while the Postal Service continues to face stiff competition from e-mail, fax, the Internet, private delivery services, we need a mail system that reaches every household across the Nation, whether an apartment building in

New York or a remote farmhouse in upstate New York or in some other rural area.

Today we have the opportunity to review the Commission's recommendations and to look at the details included in the report. As they say, the devil is always in the details, and I look forward to the testimony. And I would like to know if there are any recommendations from those that are testifying today in support or in opposition to the assessments or the recommendations that have come forward and what steps the panelists feel are necessary to achieve true postal reform.

Again, I thank Danny Davis, who heads the Postal Caucus on the Democratic side and, of course, Mr. Waxman, and my colleague from the great State of New York, our chairman. Thank you.

Mr. MCHUGH. Thank the gentlelady.

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

Prepared Statement of Congresswoman Carolyn B. Maloney of New York

before the Special Panel on Postal Reform and Oversight

January 28, 2004

Thank you, Mr. Chairman and Ranking Member Davis for holding this important hearing.

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

As we all know, the mailing industry is tremendously important to our economy.

With the Postal Service facing billions of dollars in debt over the next few years and GAO listing it on their "high risk" list, postal reform is one of the most pressing issues we will address this year.

Last year, we passed bipartisan legislation that reduced the Postal Service's contributions to the Civil Service Retirement and Disability Fund after it was determined that it had been making overpayments. This reform was expected to help the Postal Service reduce its debt to the Treasury by approximately $3 billion each year and to keep postal rates stable until 2006.

I represent much of the magazine industry, which is enormously important both for the economy of New York and many other areas. Magazines are an essential part of our culture. They educate us, and they entertain us. However, high costs have forced many magazines out of business including *Mademoiselle, Mode, Brill's Content, and Industry Standard*, leaving these workers without jobs. At a time when millions of Americans are out of work, we should protect the jobs of everyone who relies on the Postal Service for their employment.

We need postal rates that are as low as possible. I understand the importance of keeping rates affordable so that publishers, individuals, and industries can continue to use the Postal Service. Any postal reform must take a balanced approach that considers the needs of everyone who depends upon the Postal Service.

All customers deserve the best service possible from the Postal Service. While the Postal Service continues to face stiff competition from e-mail, fax, the internet, and private delivery services, we need a mail system that reaches every household across the nation whether an apartment building in my district or a remote farmhouse upstate.

Today we have the opportunity to review the Commission's recommendations and to look at the details included in the Report. I look forward to the testimony, and I would like to know from each witness if there are any recommendations that he supports or opposes, so that we will get into the record an accurate assessment of both the Commission's work and the steps that must be taken to achieve true postal reform.

Thank you.

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Mr. MCHUGH. The last member on the panel is here to speak, the ranking member of the full committee and someone who, although he wasn't here, I want to again compliment for his understanding, his dedication to this reform initiative, the gentleman from California, Mr. Waxman.

Mr. WAXMAN. Thank you very much, Mr. Chairman. I am pleased we are having this hearing today, and I am also pleased that we are starting off the issue of postal reform in a cooperative and bipartisan manner since we are addressing these issues with a starting point of looking at last year's Postal Civil Service Retirement System Funding Reform Act as a model for working together, and I look forward to continuing that cooperative approach.

The Postal Service has long operated under a set of laws written in 1970, and they have not been adapted to the changing delivery environment, and the effects are showing. Over the past few years the Postal Service has been facing an increasing financial crisis and was approaching its debt ceiling. Fortunately we did pass that bill last year which provided some immediate financial relief to the Postal Service, but this law was not a comprehensive postal reform. Today as we begin this series of hearings on the need for postal reform legislation, we need to sort through what is a vital and complex subject, and I think we have the best opportunity that we've had in years to a resolve some of these issues and put the Postal Service on a sound footing for the future.

I would like to highlight two important financial issues confronting the Postal Service. First, the pension law we passed last year changed the entity responsible for paying for the pensions or the cost of retirement benefits related to military service, shifting the responsibility from the Department of the Treasury to the Postal Service. The measure also required proposals from the Postal Service and the administration regarding the long-term treatment of such military costs. I agree with the Postal Service that these costs should be returned to the Treasury. Doing so would both relieve the Postal Service of an unnecessary burden and give the Postal Service a source of funds to deal with its unfunded health care liabilities.

The second unresolved financial issue is the escrow account created for savings resulting from the postal pension law for fiscal years after 2005. The account cannot be used by the Postal Service until Congress has reviewed and approved the Service's plan for using the savings. While the recent proposal set forth by the Postal Service contained valuable ideas, we are not satisfied with the Postal Service's explanation of its plans and have asked for more details. I do not want to leave the escrow account in place, but I need to see that the Postal Service has thought through the best use of those savings. At the very least, the Postal Service needs to demonstrate that it has a workable plan to fund the key capital investments needed to ensure its long-term viability.

I look forward to working with my colleagues. I particularly want to single out the chairman of this subcommittee Mr. McHugh, and our ranking Democrat, Mr. Davis, and the chairman of our full committee, Congressman Davis, as well. We need to think through and address the postal reform issues to give the Postal Service the tools it needs to serve the Nation into the 21st century. And I

thank the witnesses that are here today, I look forward to their testimony.

Mr. MCHUGH. I thank the gentleman again for his leadership and hard work and devotion to this issue.

[The prepared statement of Hon. Henry A. Waxman follows:]

Statement of Rep. Henry A. Waxman
Ranking Minority Member
Committee on Government Reforms
Hearing on
Special Panel on Postal Reform and Oversight
"Answering the Administration's Call for Postal Reform–Part I"
January 28, 2004

I am pleased that we are having this hearing today. I want to thank my colleagues, Chairman Tom Davis and Representatives Danny Davis and John McHugh for their hard work on postal reform. This committee had a very positive bipartisan start to addressing postal issues with last year's Postal Civil Service Retirement System Funding Reform Act. I look forward to continuing that cooperative work as we address comprehensive reform legislation.

The Postal Service has long operated under a set of laws written in 1970 that have not been adapted to the changing delivery environment. And the effects are showing. Over the past few years, the Postal Service has been facing an increasing financial crisis and was approaching its debt ceiling.

Fortunately, the postal pension law enacted last year provided some immediate financial relief to the Postal Service. But this law was not comprehensive postal reform.

Today, we will begin a series of hearings on the need for postal reform legislation. This is a vital, but complex subject. I believe that we have our best opportunity in years to address resolve this issue and put the Postal Service on a sound footing for the future.

I would like to highlight two important financial issues confronting the Postal Service. First, the pension law we passed last year changed the entity responsible for paying the costs of retirement benefits related to military service, shifting the responsibility from the Department of the Treasury to the Postal Service. The measure also required proposals from the Postal Service and the Administration regarding the long term treatment of such military costs. I agree with the Postal Service that these costs should be returned to Treasury. Doing so would both relieve the Postal Service of an unnecessary burden and give the Postal Service a source of funds to deal with its unfunded health care liabilities.

The second unresolved financial issue is the escrow account created for savings resulting from the postal pension law for fiscal years after 2005. The account cannot be used by the Postal Service until Congress has reviewed and approved the Service's plan for using the savings. While the recent proposals set forth by the Postal Service contain valuable ideas, we were not satisfied with the Postal Service's

explanation of its plans and have asked for more details. I do not want to leave the escrow account in place, but I need to see that the Postal Service has thought through the best use of the savings. At the very least, the Postal Service needs to demonstrate that is has a workable plan to fund the key capital investments needed to ensure its long-term viability.

I look forward to working with my colleagues to address these and other postal reform issues to give the Postal Service the tools it needs to serve the nation into the 21st century. I thank the witnesses for being here today.

Mr. MCHUGH. Seeing no other members of the panel here, I'd be happy to yield to one of the senior members of the full committee, a subcommittee chairman, and someone who over the years has expressed a great deal of interest in this issue, even though he has not been legislatively directly involved, the gentleman from Connecticut, Mr. Shays, if he would care to make any comments.

Mr. SHAYS. Thank you, Chairman McHugh. A very short statement to say I am here in part to just support your effort because I think you have been a rock in a very difficult circumstance, and to thank your ranking member, Mr. Davis, for being such a wonderful partner.

The Postal Service is a public and very critical infrastructure of the United States. A reformed Postal Service needs to be immune from not just anthrax contamination but from fiscal suffocation in a very competitive marketplace. And I just know that you have the full support of the chairman of this committee in your efforts and I think that this is the year we get something done and it is very exciting to see your work finally pay off. Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman.

I no sooner said no other panel members were here than the gentleman from Virginia joined us, and I'd be happy to hear from him.

Mr. SCHROCK. Believe it or not, I have no opening statement but I've got lots of questions.

Mr. MCHUGH. I appreciate the gentleman's being here.

Having said all that, let me first of all say two things—three things probably. A couple of unanimous consent request:. Gentlemen, we have your written statements, and without objection, we would ask that those be entered in their entirety in the record. Also, note that members on the committee who wish to enter written statements, whether those members are here or not—we have several, like Mrs. Miller, for example, who is on a very important CODEL to Libya and is still on her way back, who would like to make a statement—without objection, those too will be entered in their entirety in the record. And third, as some of the veterans at the front table know, it is the policy of the committee to swear in witnesses who appear, so if you gentlemen would please rise.

[Witnesses sworn.]

Mr. MCHUGH. The record will reflect that all of the witnesses responded in the affirmative.

Gentlemen, again, our deepest thanks to you. And let's get right to the meat of this hearing. And as I mentioned, we are honored to have a very distinguished panel. And first I'm pleased to yield to the honorable Brian Roseboro, who's Acting Under Secretary of Domestic Finance for the Department of the Treasury. Mr. Secretary, thank you for being here. As you heard me say, your entire written statement is entered into the record. If you could summarize to the greatest extent that is possible, that would facilitate matters, but our attention is yours.

STATEMENT OF BRIAN C. ROSEBORO, ACTING UNDER SECRETARY FOR DOMESTIC FINANCE, DEPARTMENT OF THE TREASURY

Mr. ROSEBORO. Thank you very much, Chairman McHugh. I'd like to thank you, Ranking Member Davis and the other distin-

guished members of the committee. We welcome this opportunity to testify on comprehensive postal reform today. We as well agree that, as many of you have already mentioned, the Postal Service plays a vital role in the commercial life of our Nation; however, the current business model, we feel, is not sustainable going into the 21st century. It is widely known that electronic diversion of mail volumes has caused a substantial, and likely irreplaceable, decline in first class mail. This trend is expected to continue. The Postal Service ended the latest fiscal year with large on- and off-balance-sheet liabilities. These liabilities include $7.3 billion of debt owed to the Treasury, $7.1 billion for future workers' compensation costs, $8.7 billion for operating leases, and approximately $60 billion of unfunded postretirement health care liabilities.

Recognizing this increasing financial vulnerability, President Bush took a decisive action. In December 2002, the President established a bipartisan nonstakeholders commission and tasked it with completing a comprehensive review of the key postal issues. The Commission was to articulate an integrated set of recommendations that would put the Postal Service on the path toward long-term financial viability and operational excellence. The Commission report is the most important document on postal reform in the last 30 years, in our opinion. The administration was pleased with the comprehensive array of recommendations that the Commission submitted as outlined in the President's Executive Order framing his commission. It considered the components of business, including revenue and cost. With its 35 recommendations the report takes us a great distance toward reaching a common goal; that is, to implement changes that best prepare the Postal Service to be a sound and efficient provider of services, a quality employer and a fair competitor long into the 21st century.

While the administration may not agree with every aspect of each of the 35 recommendations, we encourage congressional leaders to carefully consider how the full range of recommendations for legislative consideration might be incorporated in meaningful, comprehensive postal reform. According to the Commission, 16 of the 35 recommendations do not require any legislative action. The Commission concluded that the Postal Service could implement each of these without any undue delay connected with legislative changes.

I also note that the Postal Service transformation plan of April 2002 and the Commission's recommendations are not incongruous. In fact, they are remarkably similar. While I understand that the Postal Service management is prudent to take time to carefully analyze proposed changes and implement reform actions in a sound manner, I take this opportunity to underscore the administration's strong support for the Postal Service's efforts to implement reforms as expeditiously as possible. As Postmaster General Potter has frequently stated, the transformation plan is a blueprint for positive change and should remain a guideline for future change. We agree, and would add the Commission's recommendations to this list of action items.

In outlining the circumstances that led to where we are today, we must add the Civil Service Retirement System [CSRS], Postal Refunding Reform Act signed into law by the President in April

2003. As you well know, this act contributed significantly to the financial recovery of the Postal Service and is a tribute to the hard work and dedication of the members of this panel in particular. Thanks to this legislation, which allowed a transformation of the Postal Service's CSRS regime into a calculation mechanism that matches the Federal Employees Retirement System [FERS], the Postal Service immediately yielded an estimated $78 billion financial gain. We believe that this has established the appropriate funding provisions for CSRS.

Despite this enormous one-time gain, the Postal Service is not yet out of the woods. Even with the strong leadership of the Postmaster General and the Postal Service Board of Governors' drive and ever more competitive organization, more needs to be done. The principles that the administration would articulate for Postal Service reform are as follows: Principle 1: To implement best practices. The administration supports comprehensive reform that ensures that the Postal Service's governing body is equipped to meet the responsibilities and objectives of a business of this size and scope. We recognize the hard work the President and past Boards of Governors as well as postal management and its work force.

Principle 2: Enhanced transparency. In keeping with our desire to implement best practices, we seek postal reform legislation that takes steps to ensure that important factual information on the Postal Service's operations and performance is accurately measured and made available to the public.

Principle 3: Provide for greater operating flexibility. In return for increased transparency and accountability, and given its self-financing obligation, the administration believes that the Postal Service's governing body and management should have a greater authority to reduce costs, set rates and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.

Principle 4: Foster greater accountability. Given its existing monopoly, potentially greater flexibility for operations in this competitive position and some important segments of the delivery marketplace, we urge Congress to enact legislation that ensures that there is appropriate independent oversight to protect consumer welfare and universal mail service. We would like to see legislation that provides the corporate governing body with necessary tools to properly motivate postal management to achieve key objectives, such as increasing productivity, enhancing service and improving labor relations.

Principle 5: Ensuring self-financing. The administration is committed to its desire to see a Postal Service that is financially self-sufficient, covering all of its obligations. We believe that ratepayers should be responsible for covering liabilities, including the off-balance sheet, unfunded liabilities. By doing so the Postal Service remains motivated to operate in a manner that strengthens the financial and operational health of the Postal Service.

The administration sees postal reform as an integrated whole. It is crucial to address all aspects of the Postal Service's cost and revenue lines, its balance sheet, off-balance sheet components, its corporate governance, its competitors, as well as the taxpayers and ratepayers. Reform should be characterized by the five principles

which, when implemented, will ask each stakeholder to accept shared sacrifice in order to achieve a better, stronger and more accountable, transparent Postal Service.

Issues surrounding postal reform are indeed complex. We are in the presence today of congressional leaders such as yourself, Chairman McHugh, and others who have spent a tremendous amount of time and dedication in making the Postal Service better. Postmaster General Potter's sustained dedication to achieve this objective must also be recognized. The issues that are involved with postal reform are complex; however, the administration stands ready to work with you to take this critical issue forward.

I thank you, and I'll be pleased to answer questions at the appropriate time.

Mr. MCHUGH. Mr. Secretary, thank you for your comments, for your being here today.

[The prepared statement of Mr. Roseboro follows:]

HEARING TESTIMONY
BRIAN C. ROSEBORO
ACTING UNDER SECRETARY FOR DOMESTIC FINANCE
U.S. DEPARTMENT OF THE TREASURY
BEFORE THE
COMMITTEE ON GOVERNMENT REFORM'S SPECIAL PANEL ON
POSTAL REFORM AND OVERSIGHT
UNITED STATES HOUSE OF REPRESENTATIVES
JANUARY 28, 2004

Mr. Chairman and distinguished members of the Committee, I welcome the opportunity to testify today on the need for comprehensive postal reform.

The Postal Service plays a vital role in the commercial life of our nation. Business to business, consumer to business, and business to consumer mail comprise approximately 93% of total first class single piece mail. The postal service also plays a major communication role, connecting families and friends, making personal communication easier, and making the huge land mass of the United States a bit smaller. As one of the largest employers in America, with around 800,000 employees, many of our citizens look to the postal service for their economic and professional livelihood as well. Finally, the service provides the most common connection between citizens and their national government.

However, the current business model is not sustainable going into the 21st century. It is widely known that electronic diversion of mail volumes has caused a substantial and likely irreplaceable decline in first class mail. This trend is expected to continue. The Postal Service ended the latest fiscal year with large on and off balance sheet liabilities. These liabilities include $7.3 billion of debt owed to Treasury, $7.1 billion for future workers' compensation costs, $8.7 billion for operating leases and approximately $60 billion for unfunded post-retirement healthcare liabilities

Recognizing this increasing financial vulnerability, President Bush took decisive action. In December 2002, the President established a bipartisan, non-stakeholder Commission and tasked it with completing a comprehensive review of key postal issues. The Commission was to articulate an integrated set of recommendations that would put the Postal Service on the path toward long-term financial viability and operational excellence. To their credit, the nine commissioners completed the report on time and under budget. The process of receiving input from stakeholders through public meetings and written correspondence was given high marks for being fair and transparent.

The Commission's report is the most important document on postal reform in the last 30 years. The Administration was pleased with the comprehensive array of recommendations that the Commission submitted. As outlined in the President's Executive Order framing his commission, it was charged to consider each component of the business, including revenues and costs. With its 35 recommendations, the report takes us a great distance toward reaching a common goal: to implement changes that best

prepare the Postal Service to be a sound and efficient provider of services, a quality employer, and a fair competitor long into the 21st century.

While the Administration may not agree with every aspect of each of the 35 recommendations, we encourage Congressional leaders to carefully consider how the full range of recommendations for legislative consideration might be incorporated in meaningful, comprehensive postal reform.

According to the Commission, 16 of the 35 recommendations do not require any legislative action. The Commission concluded that the Postal Service could implement each of these without any undue delay connected with legislative changes. I also note that the Postal Service's Transformation Plan of April 2002 and the Commission's recommendations are not incongruous; in fact, they are remarkably similar. While I understand that the Postal Service's management is prudent to take time to carefully analyze proposed changes and implement reform actions in a sound manner, I take this opportunity to underscore the Administration's strong support for the Postal Service's efforts to implement reforms as expeditiously as possible. As Postmaster General Potter has frequently stated, the Transformation Plan is a blueprint for positive change and should remain a guideline for future changes. We agree, and would add the Commission's recommendations to this action list.

In outlining the circumstances that led to where we are today, we must add the Civil Service Retirement System (CSRS) Postal Funding Reform Act, signed into law by the President in April 2003. As you well know, this Act contributed significantly to financial recovery of the Postal Service, and is a tribute to the hard work and dedication of the members of this panel in particular. Thanks to this legislation, which allowed a transformation of the Postal Service's CSRS regime into a calculation mechanism that matches the Federal Employee Retirement System (FERS), the Postal Service immediately yielded an estimated $78 billion financial gain. We believe that this has established the appropriate funding provisions for CSRS. Despite this enormous one-time gain, the Postal Service is not yet "out of the woods." Even with the strong leadership of Postmaster General Potter and the Postal Service's Board of Governors to drive an ever more competitive organization, more needs to be done. That is why we are here today.

Last month the Administration announced its support for comprehensive postal reform and articulated five principles to guide congressional debate. The Administration deliberately chose not to be overly prescriptive. We feel strongly that the following five guiding principles can frame a long-term, comprehensive, solution for the challenges that loom on the short and long-term horizon.

Implement best practices The Administration supports comprehensive reform that ensures that the Postal Service's governing body is equipped to meet the responsibilities and objectives of a business of this size and scope. We recognize the hard work of the present and past Board of Governors, as well as postal management and its workforce. However, we believe that it is time to reflect on whether improvements in corporate

governance can be incorporated that will add further value for ratepayers, taxpayers, and the Postal Service's workforce and management. As was stated in the President's Commission Report: "The Postal Service should meet the highest standard of corporate leadership...applying the best business practices of the private sector to delivering the nation's mail."

Enhance transparency In keeping with our desire to implement best practices, we seek postal reform legislation that takes steps to ensure that important factual information on the Postal Service's operations and performance is accurately measured and made available to the public. The Postal Service should provide more detailed financial information, including product-by-product financial statements and expanded financial reporting, e.g., voluntary SEC reporting. We also believe there is merit to recognizing the aggregate unfunded post-retirement health liabilities and the annual current cost of such liabilities, either directly on the balance sheet or, at least, in notes to the financial statements. Given the important service this organization provides to the American people, I believe that efforts to facilitate greater access to information can contribute to better decision-making, further enhance trust among stakeholders, and improve oversight.

Provide for greater operating flexibility In return for increased transparency and accountability, and given its self-financing obligation, the Administration believes that the Postal Service's governing body and management should have greater authority to reduce costs, set rates, and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace. In doing so, we urge caution and care to avoid unintended disruption of market forces.

Foster greater accountability Given its existing monopoly, potentially greater flexibility for operations, and its competitive position in some important segments in the delivery marketplace, we urge Congress to enact legislation that ensures that there is appropriate independent oversight to protect consumer welfare and universal mail service. We would like to see reform legislation that provides the corporate governing body with necessary tools to properly motivate postal management to achieve key objectives such as increasing productivity, enhancing service, and improving labor relations. An independent regulatory body must have sufficient authority to fulfill its oversight responsibilities.

Ensure self-financing The Administration is committed in its desire to see a Postal Service that is financially self-sufficient, covering all of its obligations. We believe that ratepayers should be responsible for covering liabilities, including the off-balance sheet, unfunded liabilities. By so doing, the Postal Service remains motivated to operate in a manner that strengthens the financial and operational health of the Postal Service.

Postal reform is not the only pressing matter involving the Postal Service that is currently before the Congress. The matter of enacting a comprehensive postal reform bill comes at virtually the same time as a related matter currently under consideration by Congress - modification of the CSRS Postal Funding Reform Act. There are two issues under consideration. First, whether Treasury or the Postal Service should be responsible for a

share of the costs paid to retired employees of the Postal Service that arise from increasing Civil Service pension benefits because of military service. In this regard, as mentioned earlier, the Administration continues to believe that the Postal Service should remain responsible for these costs and would oppose a modification to the Act. Second, whether the Postal Service should be required to maintain an escrow account that will be disbursed at the discretion of the Congress. The Administration believes that it is optimal for Congress to act expeditiously on both postal reform and the disposition of the escrow as a bundled whole.

The Administration sees postal reform as an integrated whole. It is crucial to address all major aspects of the Postal Service's cost and revenue lines, its balance sheet and off-balance sheet components, its corporate governance, its competitors, as well as the taxpayers and ratepayers. Reform should be characterized by the five principles that, when implemented, will ask each stakeholder to accept shared sacrifice in order to achieve a better, stronger, more accountable and transparent, Postal Service.

Issues surrounding postal reform are, indeed, complex. We are in the presence today of Congressional leaders, such as Congressman McHugh and others, who have spent a tremendous amount of time dedicated to making the Postal Service better. Postmaster General Potter's sustained dedication to achieve this objective must also be recognized. The issues that are involved with postal reform are complex; however, the Administration stands ready to work with you to take this critical issue forward.

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

Mr. MCHUGH. And I mentioned what I thought was a very proactive position by the administration, by the President, given the first time it's been focused upon since the Nixon administration. But I would be remiss if I didn't pay a tip of the hat to the Treasury Department that really, in terms of the administration, kind of led the charge and brought the issue to that end of Pennsylvania Avenue's attention, and we appreciate deeply the leadership role that the Department played. Thank you again for being here.

With that, our next witness, as I mentioned in my opening remarks, is a good friend of this subcommittee, a good friend of the Postal Service, and a man who, not for power or glory or money, I don't believe, dedicated himself and continues to dedicate himself to the best possible Postal Service that the United States can produce, the chairman of the Postal Board of Governors, David Fineman.

STATEMENT OF DAVID FINEMAN, CHAIRMAN, U.S. POSTAL SERVICE BOARD OF GOVERNORS, ACCOMPANIED BY JOHN E. POTTER, POSTMASTER GENERAL OF THE UNITED STATES

Mr. FINEMAN. Thank you, Mr. Chairman.

Mr. MCHUGH. Thank you.

Mr. FINEMAN. I'm now in the last year of my term on the Board of Governors and you and I, Mr. Chairman, I think, began to attack this issue together almost about 8 years ago. And I want to thank you particularly, Congressman Davis, and other members of the committee who have been there with us for so long in trying to enact reform. I do want to take this opportunity to also thank the administration for putting in a lot of labor on this issue.

Mr. Chairman, I remember some time ago you and I spoke to an industry group, and I think at that time, which was probably someplace around 7, 8 years ago, I talked about a train wreck that was about ready to happen. I'm somebody from Philadelphia, and I commute here by taking that Northeast train. It begins in Boston. And if we assume that train wreck is going to occur in Washington, I'd suggest to the members of the committee that the train's about ready to leave Baltimore now and about ready to come into Washington.

There is a necessity to change the law, and I've been here and said that on numerous occasions. And the real evidence of that has been alluded to before, but a couple of facts have made it even more apparent. If you look at first class volume as an example, we peaked at about 104 billion pieces in 2001. We declined by 1 billion pieces in 2002 and declined by 3 billion pieces in 2003. The President's Commission and others really don't know where that's going to lead, and I'm not sure anybody does, quite frankly. And for the first time since postal reorganization, first class mail volume is less than 50 percent of the total of mail. All of us, every day—I'm an attorney in Philadelphia—how many pieces of e-mail do I get per day? How many documents do I get that are sent to me by lawyers from throughout the country that previously would have been sent to me in the mail? How many times do I print out letters that are sent to me by e-mail so that I can put them into my files? We know what the problem is.

I commend all of you for taking the leadership. The Board understood as well, and particularly in the last 4 years or so, I think that the Board has exerted leadership and begun to work with management as a board should work with management, and that is to say to management, "Look, these are the things that we want to get done." And management, the Postmaster General, has executed that plan. I think it began by us saying some time ago—I was looking at testimony before this committee some time ago when we froze facility spending, capital spending. It wasn't that popular with some of the Members of Congress, but it needed to be done. And what we did by doing that was to begin to change the way we spend money at the Postal Service and begin to have more money to spend and to be able to keep rates at a level that made a little bit of sense. We began to examine our core values. So we did look at the e-commerce area, where a lot of money had been spent, and my testimony reflects it wasn't a good venture. And the Board put pressure on management, and you'll notice that we are not involved in those kinds of issues anymore. We selected a Postmaster General, who I'll speak about a little bit later. We reduced the average interest rate that we now pay on our debt from 5.1 percent to 1.1 percent. More importantly, we said to the Postmaster General, "It looks to us like we have to decrease our career complement, that is the number of employees we have. And that's declined by 24,000 in 2003 and will probably decline by 11,000 more positions next year. And we did that, I would suggest, by working closely with our labor unions, without having any layoffs; and it was done with attrition and cooperation with our labor unions. And what we need now is to attack, as Congressman Waxman has indicated, our facility and infrastructure. You know, in Philadelphia, for years the Postal Service building was across from the train station, and that is where it's located in so many major cities, and that's because mail traveled on trains. Mail doesn't travel on trains any longer. It travels on an interstate highway system. We've got to be able to rationalize what this infrastructure and network system is. And I commend the leadership also of David Walker. I think that by issuing his report—and he has said to us that we need to look closely at many issues, and I commend you for doing that, and it gave us the discipline to do that. But now we need help. We need help to change the laws.

As you know, Mr. Chairman, the entire Board, at least since March 2001, has sent a letter to Congress and to the President, and we've testified before the President, the Commission, and we have said that we need change. And we agree to a large degree with most of what the President's Commission has said. The President's Commission raised the issue of transparency, and the Board reacted to it. I think that you'll see within the next months reports that are far in excess of, I think, what might be—the SEC requirements are going to be. We are going to report on a monthly basis. We are going to take action to be as transparent as we can, but we need additional flexibility.

The rate process is broken. There's no necessity for me to testify at length about that. I've done it before. We can support a system that includes well-constructed price caps which—when we need special relief, we are going to need special relief in exigent cir-

cumstances. And as many of my friends know, many of us, I've been a strong advocate of collective bargaining. I do not believe that the Commission should, or a postal rate commission, or a postal regulatory board should interfere in any way with the collective bargaining process. On the other hand, I do believe that everything should be on the table for collective bargaining, including health benefits.

There are, as Congressman Waxman has indicated, and as others, two important legislative issues before Congress in the near term, funding of the military service cost and eliminating the escrow provisions. And all that I ask is—as chairman of the Board, is that we attack those issues quickly. And the reason that I say that is if we have the present law that we operate under, which is a ridiculous ratemaking process, we have to set—we have to propose rates to the Postal Rate Commission some 10 months before rates would be enacted. We have to begin to work on that system, I've said, 18 months to 24 months ahead of time. We need action on this, so that we, the Board, can talk about rates and can consider rates in a considered manner.

Where we disagree with the President's Commission, or where I disagree, are basically three areas, one I've mentioned already being collective bargaining. The other is the Postal Regulatory Board, and I think that the Postal Regulatory Board, there has to be a clear line between what your functions are, the managerial, the public policy decisions about universal service, about the monopoly, and those that the Postal Regulatory Board would make. And second of all, and I guess there's nobody who should shun their responsibility, but rather to comment upon what the President's Commission has recommended in regard to its Board of Directors, I personally don't care if you change the name from Board of Governors to Board of Directors, but I think that one of the most important things that we can do is to keep the bipartisan nature of this Board. We have not had Democrat and Republican fights on this Board. It has five of one party and four of another. The President's Commission, I think well intended, could result in a very highly partisan Board, which I would not like to see happen. There are, in that report, certain age restrictions which I think are appropriate. However, I think that the bar of 70 years of age, we might raise it a little bit. You know, Jack McKeon did win the World Series. He was about 72, so I am not sure that's appropriate.

In conclusion, Mr. Chairman, I am saying that we can do—we're doing everything we can, but the business model from 1970 is no longer valid, and we're reaching the limits of what current opportunities are available to us, and we've got to change those assumptions. I think that you and I, Congressman Davis, Congressman Waxman, I see here, you know we've said the time is now on numerous occasions, but I'm telling you that train is about ready to run into Union Station, and it's about time that we really made some changes. Before I conclude, I do congratulate all of you on working in a bipartisan way to change this law, and I look forward—I want to say that I'm about ready to finish my term, and I do look forward to working with all of you on changing that law,

and I continue—even if I should be gone within some period of time as chairman of the Board, I would look forward to continuing our relationship to change this law. I think I have a lot invested in it at this point.

[The prepared statement of Mr. Fineman follows:]

STATEMENT OF DAVID FINEMAN, CHAIRMAN
UNITED STATES POSTAL SERVICE BOARD OF GOVERNORS
BEFORE THE
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT
COMMITTEE ON GOVERNMENT REFORM
U. S. HOUSE OF REPRESENTATIVES
JANUARY 28, 2004

Good afternoon, Mr. Chairman and Members of the Special Panel.

I appreciate the interest of this committee in assuring the continuance of affordable universal mail service for each and every American. Thank you for the opportunity to talk with you about the critical issue of comprehensive legislative reform for the United States Postal Service.

As you know, the Postal Service Board of Governors directs the exercise of the power of the Postal Service. It establishes strategic policies, basic objectives, and long-range goals for the Postal Service. We take these responsibilities very seriously.

I have had the pleasure of being a member of the Board of Governors of the United States Postal Service since 1995. Over the course of those nine years, I have worked closely with my fellow governors to conscientiously carry out our legal mandate to "direct and control the expenditures and review the practices and policies of the Postal Service". I also came to realize early on that the law under which we operate is both antiquated and inefficient. I have had the pleasure of getting to know many of you and your staff as I have worked with you towards bringing about change to this law.

I have also come to appreciate the value of mail service to the American people and the role it plays in making the US economy the greatest in the world. I am proud of the thousands of dedicated Postal employees who manage to get the mail delivered regardless of the obstacles faced. We have faced some significant challenges in the last few years, and I want to thank every member of this Panel, the General Accounting Office, and the Administration for their assistance in helping us address them.

In 2003, the United States Postal Service set records in service, productivity and customer and employee satisfaction, while also maintaining universal mail service and generating a positive bottom line for the business.

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

An analysis by the Office of Personnel Management found that, without a change in our payment schedule, the Postal Service would overpay its obligation to the Civil Service Retirement System by $105 billion. Quick action by Congress and the Administration resulted in legislation to avoid this overpayment.

The savings available through the new law helped us reduce outstanding debt by more than one third, from $11.1 billion to $7.3 billion, and make it possible for us to continue reducing debt in 2004 and hold postage rates steady until at least 2006.

But these successes are masking a basic flaw in the business model upon which the Postal Service was founded. The assumption that growth in mail volume will provide sufficient revenues to meet the cost of providing universal service to an ever-growing number of delivery points is no longer valid.

The goal of the 1970 law creating the modern Postal Service was to provide universal, affordable mail service to everyone in America while maintaining a focus on self-sufficiency and the bottom line. For many years, the legislation has been very successful. Over the course of the past three decades, postage rates have risen at about the rate of inflation and the Postal Service has been modernized to meet the changing service needs of businesses and the public.

However, the Postal Service faces a major structural change in the way Americans conduct business. Electronic alternatives to hard copy mail are becoming increasingly acceptable to the public and will continue to divert significant portions of the mail stream away from the Postal Service and onto the Internet.

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

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

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

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

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

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

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

But the decline in volume and the change in the mail mix took away $668 million in revenue contribution last year alone. This is the same as adding an extra one percent to our cost base.

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

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

Additionally, strong immigration, younger members of the baby-bust generation living on their own, aging baby-boomers purchasing second homes and shifts in family composition contribute to a projected average annual demand for 1.7 million new housing units.

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

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

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

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

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

We are managing for results. We have asked management to focus on three key strategies: improving operational efficiency, adding value for our customers, and enhancing our performance-based culture.

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

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

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

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

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

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

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

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

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

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

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

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

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

At the time we began our review in February 2001, e-commerce spending was $33 million annually, producing gross revenue of only about $2 million. Today, the Postal Service is spending less than one million dollars a year on e-commerce, with projected gross revenue of $5 million.

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

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

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

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

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

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

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

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

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

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

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

Once again we need your help.

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

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

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

We have been advocating this position for some time now. As previously mentioned, I have personally worked with many of the members of this Panel as legislation was developed to address these issues.

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

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

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

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

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

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

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

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

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

We cannot be asked to conduct ourselves in a businesslike manner when the tools to do so are not available to those running the business.

We fully understand that with an increased level of management flexibility must come an appropriate 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 President's Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service cannot have as a government institution.

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

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

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

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

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

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

Today, the Governors are appointed by the President with the advice and consent of the Senate. They serve staggered nine year terms, and by law, no more than five members may belong to same political party. This structure has allowed the Postal Service to enjoy bipartisan oversight and consistent governance of this $68 billion national service provider. We are concerned that the Commission's proposal for a new Board of Directors could change this.

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

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

Rather than becoming more impartial and businesslike, a Board of Directors as envisioned by the Commission could be less impartial, less knowledgeable, and possibly more political.

From previous testimony, you know that the Board of Governors is on record in favor of reform of the current ratemaking structure.

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

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

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

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

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

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

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

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

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

And speaking of benefits, we are on the record as recommending that the obligation to fund the military service costs of postal employees' Civil Service Retirement System retirement benefits return to the Department of the Treasury. And we have also recommended that the escrow provisions of the Act be eliminated and that the "savings" be used to fund retiree health care benefits, retire debt or fund capital expenditures. Both of these issues could have a profound effect on our ability to manage to the bottom line in the years ahead, and the Postmaster General will address these topics in greater detail in his remarks.

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

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

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

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

But we are reaching the limits of the current opportunities available to us. We cannot keep pulling rabbits out of our financial hat. That is no way to run a business.

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

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

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

The conversation has already begun. The Commission brought informed proposals to the critical consideration of the future of our nation's mail service. The President has made recommendations based on the Commission's report. The Board of Governors of the Postal Service intends to remain engaged in that discussion as well.

And we will continue to do everything in our power to assure that the Postal Service of the 21st century will continue providing affordable, universal mail service for all customers and all communities in America.

Thank you, Mr. Chairman and Members of the Special Panel.

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Mr. FINEMAN. With that, Mr. Chairman, I'd like to introduce the Postmaster General, if I could.

Mr. MCHUGH. Please do.

Mr. FINEMAN. That is one of the key decisions that the Board has to make, from time to time, is to choose the Postmaster General. We chose Jack Potter as a career employee of the Postal Service because we understood that we needed someone who was willing to make tough decisions, and willing to make hard decisions, understanding the desperate place that the Postal Service was in. Jack has made those decisions and at the same time has created an atmosphere that I have never seen before between our labor unions and ourselves. He's done that in a manner that is really admirable and, I think, clearly one of the best decisions that we made was to have Jack Potter as our Postmaster General. So with pleasure, Mr. Chairman, I would like to introduce the Postmaster General.

Mr. POTTER. Thank you, David. And I, too, want to add my thanks to every member of the special panel for the opportunity to add to the discussion of the need for comprehensive postal legislative reform. I want to thank you, Chairman McHugh, for your personal commitment over these many years. It's been a long struggle. I'm also grateful to Congressman Davis, Congressman Waxman and Congressman Davis who's not here, Congressman Burton for all of the efforts that have been made to move postal reform. And there are many people on the Committee on Government Reform and they too have taken part in leading the way to protect and preserve universal mail service for all Americans well into the future. My compliments to the administration—and Brian's here representing them—the Congress, to my friend Comptroller General David Walker for recent legislation that adjusted the Postal Service's payments to the Civil Service Retirement System. The legislation has provided a period of rate stability for the American people and American businesses until at least 2006. Given the challenging economic conditions in recent years, stable rates could not have come at a better time. In addition, the legislation allows us to significantly lower our debt.

However, there are two open issues remaining that we need to discuss regarding the 2003 CSRS legislation that require your action, and Congressman Waxman mentioned them. The first open issue concerns shifting to the Postal Service from the Treasury the retirement liability costs of our employees' military service before they became postal employees. This obligation transferred payment of more than $27 billion from taxpayers to ratepayers.

Last year the President's Commission examined the impact of the move. In its final report, the Commission recognized the complexity of the issue, understood the long-term financial ramifications, and recommended that Congress reverse the position. We agree with the Commission and with Congressman Waxman. Not only does $17 billion of the $27 billion represent a repayment of funds already provided to retirees by the Treasury, but more than 90 percent of the $27 billion obligation results from military service performed before the Postal Service was established in 1971. We believe that these military service obligations should be returned to the Treasury and not be the responsibility of postal ratepayers.

Further, we propose that the funds required to finance the $27 billion military service cost instead be allocated to fund our long-term obligation and retiree health care benefits estimated to be between $47 and $57 billion. Funding retiree health care has been a major issue for the GAO and the Congress, and we believe has greater priority than funding military service costs that have no linkage to operating the Postal Service. Finally, our proposal is that these funds stay in the CSRS fund, and therefore will not negatively impact the Federal deficit in a significant way. I look forward to continued discussion on this proposal with this committee.

The second issue deals with an escrow account, as previously mentioned. As constructed in the legislation, the Postal Service will be required to put the CSRS, "savings," in fiscal years 2006 and beyond into escrow pending congressional review. In effect, in 2006 the requirement could negate the very benefit the CSRS legislation made possible by putting postal customers back where they started before the legislation was enacted.

I agree with Congressman Waxman that we need to deal with this escrow fund and put it to bed. Moreover, the rate increase required to fund the escrow could have a damaging effect if we were made to create it on the mailing industry and businesses that rely on the mail to reach their customers. I recognize the intent of the provision in last year's legislation, and let me assure you that postal management and the Postal Board of Governors will not in any way squander the benefits gained from reduced CSRS benefit payments. As requested, we are now developing added detail relating to our networks and employee complement requirements in the future. I look forward to continued dialog on this issue. We really want to make sure that this committee is satisfied with our response. Resolution of these issues in this session of Congress will help us in every mailer segment in this country as we examine our revenue needs for 2006 and beyond.

The Postal Service has made great strides in the past few years. As chairman of the Board Fineman mentioned, there is a mood of optimism among our employee and management ranks that we can do things we never thought possible. This can-do attitude transcends every aspect of our business and compels us to reexamine long-held presumptions. In 2003, we experienced our fourth straight year of increased productivity. We achieved record levels of service in all measured categories. We saw customer satisfaction reach record levels. We saw workplace environment indicators reach record levels, too. There is a new positive and constructive relationship between labor and management as evidenced by significant reduction in employee grievances and voluntary contract extensions that we reached with several major unions. We have been aggressively, and with common sense, managing the business, and we will continue to do so.

Yet for all the success that we have had, no one should be lulled into a false sense that all is right with the postal world. As Chairman Fineman pointed out, the underlying business model remains problematic and compels legislative change if we are to continue to provide the American people and American business with a similar level of affordable service that we have today. No, the Postal Service is not broken today, nor will it be broken in the next year or

the year after; however, mail volume trends are a cause for concern. Without new growth opportunities and aggressive cost reductions, we could be forced to raise rates such that volumes will decline precipitously.

Management and the Board must have sufficient tools to increase revenue and lower costs to meet the changing customer needs for mail services. We should not wait for a crisis event. That is why I applaud the foresight of the President and this committee to craft a new blueprint. We can and should buildupon the President's Commission recommendations and the five principles outlined by the President. As detailed in my written testimony, I believe a sixth principle is the commitment to a strong collective bargaining process.

I look forward to working with each of you on legislation that addresses the need for pricing flexibility, including annual adjustments; that includes appropriate regulation and transparency; that provides management and the Board with the necessary authority to adjust postal network infrastructure of plants and post offices with appropriate community input; that defines public policy responsibilities among management, the Board, the regulator, and the Congress regarding issues such as universal service; and one that takes a fresh look at the collective bargaining process to strengthen the relationship between management and labor, balancing the legitimate concerns of the customer. With Chairman Fineman and the Governors of the Postal Service, I look forward to developing, at this unique time in our history, legislative reform that works for the American people, works for our employees, and will deliver for America. Thank you very much, Mr. Chairman.

Mr. MCHUGH. Thank you.

[The prepared statement of Mr. Potter follows:]

TESTIMONY OF
JOHN E. POTTER
POSTMASTER GENERAL/CEO
UNITED STATES POSTAL SERVICE
BEFORE THE
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT
COMMITTEE ON GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
JANUARY 28, 2004

Chairman McHugh and members of the Special Panel, I welcome the opportunity to meet with you today to discuss the very real need for comprehensive reform of the legislative framework governing the Postal Service. For a number of years, Chairman McHugh, other members of this Panel and the Committee on Government Reform have recognized that fundamental change is necessary to protect the right of affordable, universal mail service for everyone in America. In addition to Chairman McHugh, I particularly want to recognize Committee Chairman Tom Davis and Representatives Dan Burton, Henry Waxman and Danny Davis for their work on this issue.

Their efforts resulted in in-depth explorations of the economic factors and market dynamics that, in the long term, threaten the ability of the Postal Service to carry out its mission successfully. More significant, they were willing to propose solutions in the form of legislation that would modernize the 34-year-old law that established the Postal Service.

We are grateful for those efforts to address this situation before it results in a crisis. As Chairman McHugh has said often, "the time to fix the roof is now, before it rains." I agree.

Chairman McHugh's leadership and forward thinking have helped to educate the entire postal community on this issue. And the action of the President in creating a Commission on the United States Postal Service has complemented those actions.

As you have heard from S. David Fineman, Chairman of our Board of Governors, both the Governors and management of the Postal Service support modernization of the charter that created the Postal Service. We also understand that in today's extremely challenging communications market we must manage our business as effectively as possible.

That is what we are doing. Since I assumed the role of Postmaster General, transformation of the Postal Service has been our central focus. And I am pleased that the President's Commission on the Postal Service acknowledges that our Transformation Plan is guiding us to substantial progress in adapting to an uncertain future. Clearly, it is taking us in the right direction.

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

We have reduced our career employee complement by over 80,000 – a ten percent reduction from its peak level in 1999. Only 70 American companies have as many as 80,000 employees on their rolls.

We have delivered $5 billion in cost savings since 2000. This includes $2.7 billion in savings resulting from Transformation Plan initiatives over the past two years. We are on track to surpass the $5 billion in savings called for by the Transformation Plan over the five-year period ending in 2006.

Consistent with our Transformation Plan goal of enhancing a performance-based culture, we have established pay-for-performance systems for managers, executives, postmasters and supervisors. The new system links 100 percent of pay increases to performance. We have brought service performance and customer satisfaction to their highest levels. We have improved the workplace environment, measured both by reductions in grievances awaiting arbitration and quarterly employee surveys. We are aggressively managing the business. This will not change.

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

Without the correction provided by this legislation, the Office of Personnel Management and the General Accounting Office 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 Chairman Davis and the Committee on Government Reform, as well as the administration and the General Accounting Office for their 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. This same legislation, however, presents very definite challenges, which I will also address today.

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.

It is important that I take a moment to acknowledge that the success of the Postal Service over the last three decades is largely a result of the new business model that was created by the Postal Reorganization Act of 1970. The Postal Service is self-sufficient. Postage rates have largely tracked the rate of inflation. And, by the end of this fiscal year, we will have achieved the Act's mandate that the Postal Service "break even" over time.

Yet, as we continue to improve efficiency, we recognize that opportunities for savings and improvement will grow increasingly limited. New tools will be necessary.

Many – in the Postal Service, the mailing community, and in Congress – have long recognized that, despite the success made possible by the 1970 Act, the business model it created is becoming increasingly disconnected from today's reality. It is outdated and inflexible. The Postal Reorganization Act was predicated on the assumption – valid for most of the last 34 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.

The productivity improvements of the last few years, coupled with reduced pension payments resulting from the CSRS legislation, have masked the need for change in the Postal Service. 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.

The facts speak for themselves.

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

In 2003, extremely focused efforts in managing our business and the impact of the Civil Service Retirement System payment reform legislation, combined to result in a net income of $3.9 billion. Even without the welcome relief of the CSRS legislation, continued cost reductions and increased productivity would have resulted in a net income of $900 million. This was, in itself, a 50 percent increase over plan.

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.

But, as Chairman McHugh's pioneering work has validated, 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. These factors will 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. In fact, in 2003 First-Class Mail volume was less than half of our total mail volume – for the first time in our history.

President Bush's creation of a Commission to examine the Postal Service was an important acknowledgement of the forces driving the need for change. I thank the Administration for its willingness to take on this critical public policy challenge sooner rather than later. The Commission's report, defining a proposed vision for the future and recommending legislative and administrative reforms needed to ensure the vitality of postal services for the American people, adds greatly to this important conversation.

In particular, I would like to recognize the efforts of the Treasury Department for its role in implementing the President's mandate. In addition, Commission 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 understood 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 understood the need to act before there is a crisis that imposes hardship on the public.

Last month, the President urged Congress to enact postal reform legislation based on the five key principles contained in the Commission's final report.

The President's first principle is that a new legislative charter should implement best practices. It should ensure that the Postal Service's governing body is equipped to meet the responsibilities and objectives of an enterprise of its size and scope.

In this area, the Commission recommends significant changes to our governing board. The nine 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.

I ask that you keep these points in mind as you proceed with your consideration of this issue.

The Commission's report also recognized that the Postal Service should take advantage of corporate best practices that are necessary for long-term success in serving the nation.

In this regard, we have established and 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. While we face statutory limitations on some of our buying activities, we will also revise our purchasing regulations, within the scope of existing legislation, to reflect corporate best practices that can improve our operating and administrative practices and ensure that we receive maximum value with every purchase.

The second guiding principle identified by the President is transparency. This would ensure that important factual information is made available to the public in a timely manner.

While the President's Commission noted 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. As you have heard from Chairman Fineman, the Postal Service is making significant progress in enhancing its financial reporting in a number of key areas. These include annual and quarterly financial reports and enhanced disclosure and reporting of significant events. Management will continue to follow the guidance of the Postal Service governors in this important area.

The third principle of reform identified by the President is flexibility. This would ensure that the Postal Service's governing body and management have the authority to reduce costs, set rates, and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.

In short, management needs the flexibility to manage. From my standpoint, I consider this the litmus test for postal legislative reform.

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

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 any proposed network optimization process will lead to office-by-office or facility-by-facility decisions, and, therefore, are more local than national decisions.

The Commission's recommendations on rate setting 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 proposed 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.

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.

Another of the President's reform principles is a self-supporting Postal Service. This is intended to ensure that a Postal Service operating with greater flexibility is financially self-sufficient, covering all of its obligations.

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, while covering its costs. Certainly, the establishment of a new rates process that provides management with greater flexibility will come with increased regulation to assure that there are no abuses of monopoly pricing. Price caps are under consideration as a tool to protect customers. They must also protect the Postal Service.

A properly constructed price-cap proposal can contribute to accomplishing 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 and the level of service provided.

To be effective, a price cap must rely on projections. In a stable market, such projections may be reasonably accurate. In today's dynamic communications and delivery environment, it could be difficult – if not impossible – to accurately forecast cost and revenue trends for the extended period that would be covered by a price cap. Without some level of surety behind the projections, actual market conditions could quickly render a price cap ineffective.

As an example, let us examine some relatively recent mail volume assumptions. At the beginning of fiscal year 2001, the Postal Service published its *Five-Year Strategic Plan* for fiscal years 2001 through 2005. Management projections contained in the Plan built upon work undertaken in conjunction with government and private-sector experts. That Plan recognized the potential for diversion of some mail volume to electronic communications over time.

Based on historical trends, the Plan projected total mail volume of 230 billion pieces for fiscal year 2004. Even with the Plan's "rapid diversion" scenario, we projected that mail volume would be 213 billion pieces in 2004.

Today, using a likely "baseline" scenario that assumes a delayed economic recovery and current rates of electronic diversion, our 2004 projection calls for 204.3 billion pieces of mail. A "pessimistic" forecast, based on a longer-term economic slump and an increased rate of diversion, projects mail volume of only 202 billion pieces in 2004.

We acknowledge, of course, the unanticipated consequences of the terrorist attacks of 2001 and their magnifying effects on an already cool economy. However, the outlook for mail volume and revenue growth for the next five years is less promising than the period covered by the previous *Strategic Plan*. Major mail categories have experienced the greatest volume declines since the Great Depression, and are expected to be weak into the future. While it is still not clear how much of the volume loss is due to the current business cycle and how much is due to more lasting factors of technological change and competition, there is ample evidence that both forces are at work.

In short, a price-cap regime could bring some level of relief to a rate-setting process that severely limits our ability to respond to real-time market dynamics. At the same time, we strongly believe that marketplace uncertainties mandate that a price cap be just one element of comprehensive reform legislation that provides the Postal Service with flexibility in other critical areas that could offset a the limitations of a price-cap rendered less effective by unanticipated circumstances.

As an organization, we have reduced debt by more than one third. We are close to achieving our "break-even" mandate, eliminating the negative equity that has accumulated over the last three decades. We have become more productive and efficient than ever. We cannot risk these very real financial accomplishments, and their benefits to all mail users, by relying only on a limited reform strategy of price caps.

Success in the area of self financing would also involve our ability to retain earnings. We agree with the Commission that 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.

Financial self sufficiency may also require additional flexibility in product and service offerings. 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 maintain the flexibility to pursue appropriate revenue streams to protect our ability to provide universal service. Our intention is that any such activity would be in areas related to our core business.

The President's five principles for reform also include accountability. There can be no objection to providing that a Postal Service operating with greater flexibility has appropriate independent oversight to protect consumer welfare and universal mail service.

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 President's Commission has defined for the Postal Regulatory Board. Yet regulators are normally required to operate within limits and guidelines. Regulated private companies and their shareholders have legal protections against arbitrary action by the regulator that the Postal Service would not have under a Postal Regulatory Board model.

For instance, a Postal Regulatory Board, as envisioned by the Commission, 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.

We agree with the Commission that the letter and mailbox monopolies are essential to support a universal service mandate. Yet the Commission 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.

At the least, in the area of accountability, 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.

But accountability must be more than a function of external oversight. It must be a part of every activity within our organization, as well. And we are working to expand accountability throughout the Postal Service. Our new pay-for-performance system moves us further in this direction, directly linking compensation for management employees to their achievement of specific business goals. Individual performance indicators are aligned with customer service, revenue generation, cost management and enhancement of a performance-based culture.

To the President's list of five guiding principles for reform, I would add a sixth: a commitment to the collective-bargaining process. The Postal Service has been, and continues to be, a strong supporter of collective bargaining. Long-term financial and operational success, under any model, will require its continuation. 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.

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.

As I mentioned, we have been very successful in cutting costs over the last four years. However, in some areas, structural issues – particularly as they reflect employee benefits – prevent similar success.

For example, in 2003 alone, benefit costs, including retirement contributions, health benefits, retiree health benefits and workers' compensation represented more than $13 billion – some 20 percent of our operating expenses. These costs continue to increase year to year at rates beyond normal inflation. While the Postal Service does negotiate the employer share of health benefit premium payments with its unions, the actual premium costs and the benefits offered by the plan are established by the Office of Personnel Management. Similarly, the workers' compensation program available to our employees was established by statute and is administered by OPM.

Workers' compensation represents a sizeable portion of our compensation and benefit costs. In fiscal year 2003, $1.5 billion in workers' compensation costs accounted for 2.9 percent of our total $50.5 billion in compensation and benefit costs. At the end of 2003, total liability for future workers' compensation costs was $7.1 billion. In addition to the $1.5 billion expense in 2003, an additional $704 million was paid in compensation and benefit costs for employees with work-related injuries in either limited duty or rehabilitation positions. And, despite growth in workers' compensation costs, our on-the-job illness and injury rates have been declining.

These amounts do not include the liability for Post Office Department compensation claims incurred before postal reorganization. Under the Postal Reorganization Act of 1971, the U.S. Government remained responsible for payment of all Post Office Department workers' compensation claims incurred before July 1, 1971. However, under the Balanced Budget Act of 1997, the remaining liability for these claim costs, estimated at $258 million, was recorded as an expense by the Postal Service. The liability for these Post Office Department claims at the end of fiscal year 2003 was $122 million.

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

Employees who receive benefits through the Office of Workers' Compensation Programs receive either two-thirds or three-quarters of their basic salary, based on their dependent status. These payments are nontaxable. In many cases, these compensation payments can be as much as 25 percent more than what the employee would receive in comparable retirement payments through the Office of Personnel Management.

Comparing two individuals, each at age 55 with 30 years of service at the end of 1993, and each at level 5, one of the most common pay grades, we find a disturbing disparity. One selects optional retirement from the active workforce and the other continues to receive workers' compensation benefits. Over a ten-year period, the individual who chose not to retire, but to continue receiving workers' compensation benefits, receives $95,000 more than the employee who chose to retire. And, for the individual receiving workers' compensation benefits, an annuity based on a higher earnings history results in a higher survivor annuity. This disparity in payment actually serves as a disincentive to retire, driving up workers compensation costs for the Postal Service.

A recent audit by the Postal Service's Office of Inspector General found that more than 2,000 Postal Service employees age 65 or older are on OWCP's periodic rolls; of that number, 382 are 89 or older. More than 3,000 of our employees have been on the periodic rolls for at least 20 years; 81 of these employees for at least 40 years.

While the Postal Reorganization Act of 1970 requires the Postal Service to bargain with its unions, workers' compensation was specifically excluded.

The President's Commission recommends that collective-bargaining include the ability of the parties to negotiate for benefits as well as wages. We agree with this position and emphasize that 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.

We disagree with the Commission in its recommendation that the proposed Postal Regulatory Board determine the range within which wages would be negotiated. Such authority could impede the ability of the parties to successfully negotiate agreements and should not be within the role of the regulator.

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 Commission has taken the position that the proposed Postal Regulatory Board should make a "comparability" determination that would presumably end that argument. We believe this is unwarranted. Comprehensive reform legislation that would allow the parties to negotiate wages, hours, conditions of employment, and all benefits would make the perceived need for such a determination unnecessary. The Postal Service and its unions must be permitted to engage in direct negotiations which balance the needs of all parties without imposing 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 of this Panel in holding a series of hearings to review the issue of legislative modernization within the perspective of the recommendations of both the President's Commission and the President's principles of reform. Through its actions of the past year, the administration 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 both the Congress and the Administration.

Earlier in my testimony, I mentioned the effect of Civil Service Retirement System reform legislation on the Postal Service's finances. While this law has provided benefits to the Postal Service and those it serves, it has also resulted in a number of 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. 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. In most 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. While, in their recent review of this issue, the General Accounting Office and the Office of Personnel Management suggest that it might be reasonable to argue that the Postal Service should be responsible for these costs, because it hires an employee knowing of past military service, we disagree with their reasoning and position as being counter to public law and policy, since military service has no direct bearing on postal operations and all taxpayers benefit from military service.

The CSRS payment reform 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 Cost-of-Living Allowances 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 contributing to debt reduction, both last year and this year, 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.

With a continuing, future, escrow-funding requirement, we would have to continually and frequently increase rates simply to fund the escrow account. 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 early as 2006 through the higher rates required to fund the escrow account. This would put postal customers back where they started 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.

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. This is our preferred alternative.

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 savings from the account be used to begin pre-funding post-retirement health benefit costs for newly hired Postal Service employees.

We are pleased that the General Accounting Office found that both of our proposals were consistent with the CSRS funding reform law.

The Postal Service's preferred proposal responds to the Sense of Congress regarding the appropriate use of "savings" under the Act and re-directs nearly all Postal Service over funding of CSRS to pre-fund retiree health benefits. As disclosed in our 2003 Annual Report, we estimate the value of this long-term obligation as being between $47 and $57 billion as of the end of FY 2003. Under this preferred proposal, we estimate that in 2006 alone, at the inception of the proposed plan, we would contribute $5.0 billion to the Postal Service retiree health benefit fund. This amount is $1.2 billion greater than the CSRS and retiree health benefit funding we would provide under current laws. I should point out that the USPS is the only federal agency that pays directly for retiree health benefit costs.

This preferred proposal uses Postal Service funds for recognized Postal Service obligations, the legitimate business purpose for which these funds were collected from postal ratepayers over the last 32 years. In pre-funding retiree health benefits as we propose, the Postal Service will reduce the pressure on rates, lessen the burden on future postal ratepayers, and help strengthen the long-term promise of providing universal mail service to the American public.

In connection with the escrow provision, and at the request of Special Panel Chairman McHugh, Committee Chairman Davis and Committee members Henry Waxman and Danny Davis, we will be providing additional information about how our Five-Year Capital Plan ties both to our Strategic Plan and Transformation Plan. Through our Five Year Strategic Plan – which fully complies with the Government Performance and Results Act – and our recent Transformation Plan Progress Report, we have reported to Congress on our plans and the state of our progress.

We believe, however, that using the escrow requirement as an additional oversight mechanism simply is not necessary and, further, will force the Postal Service to raise rates to generate billions of dollars in revenues over which we can exercise little control. We believe that our preferred proposal, under which military pension costs are the responsibility of the Department of the Treasury, and the Postal Service prefunds retiree health benefits, is in the best interests of the American taxpayers as well as all postal stakeholders. As the GAO has recognized, this proposal achieves a fair balance between current and future ratepayers while allowing the Postal Service to prefund a greater portion of its long-term obligations.

At this point, I should mention that, as provided for in the Pension Reform Act, the Postal Service has filed an appeal with the Board of Actuaries of the CSRS pertaining to the methodology OPM used in determining Postal Service CSRS obligations. The allocation method proposed by OPM burdens the Postal Service with an inequitable allocation of CSRS costs. We proposed an alternative method that we regard as more equitable and consistent with allocation methodologies previously used by OPM.

Accordingly, we have asked the Board of Actuaries to reconsider, review and make adjustment to the methodology and determinations made by OPM in this matter. With the refinement we have proposed, the Postal Service could immediately fund its full current obligation for retiree health benefits and pre fund remaining retiree health care costs on a current basis as recommended by the GAO.

Mr. Chairman, I have been asked for my vision of the Postal Service. We need a Postal Service that has the incentives necessary 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 Panel and others in 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.

# # # #

Mr. MCHUGH. And I certainly want to associate myself with the words of the chairman of the Postal Board of Governors with respect to the great work you have done, Jack. We appreciate that effort and look forward to our continuing partnership in that regard.

I would note we were just notified that sometime, 3:15, 3:30, we are going to have votes. I would therefore suggest, and that is all we can do in this great democracy, suggest our last two witnesses do the best they can, and I would like to at least get through the oral presentations prior to the vote. I think that would facilitate all of our schedules. So to the extent that is possible, we appreciate your cooperation.

With that, Mr. George Omas, whom I said is no stranger to this Hill, and certainly spent long and very dedicated service in the Post Office Civil Service Committee in his previous life, and now serves, of course, as chairman of the Postal Rate Commission. George, welcome. We look forward to your comments.

STATEMENT OF GEORGE A. OMAS, CHAIRMAN, U.S. POSTAL RATE COMMISSION

Mr. OMAS. Thank you, Mr. Chairman.

Mr. Chairman, members of the committee, thank you for inviting me to present testimony to the Special Panel on Postal Reform and Oversight of the Committee of Government Reform. I am pleased to have the opportunity to discuss the need and prospects for comprehensive postal reform, focusing on the five principles recently suggested as guides by the administration.

Starting with your efforts almost 8 years ago, Mr. Chairman, there has been a gradual awakening to the necessity and potential benefits of modernizing the Postal Service. The administration should be commended for bringing this issue of postal reform to the forefront of public debate by establishing a blue ribbon commission to review the problems and then releasing its five principles for postal reform. We at the Postal Rate Commission agree that modernization is essential, that legislation is necessary to accomplish it, and that these five principles provide a sound foundation for going forward.

The administration calls for the Postal Service to implement corporate best practices to meet its responsibilities and objectives. The President's Commission suggested that the Postal Service's Board of Directors and senior management need greater flexibility to manage without some limitations imposed by current statutory constraints. To counterbalance greater management independence, the Commission also recommended 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. I support, as does the Commission, enhancing both Postal Service flexibility and accountability. This balanced approach is directly in line with the principles proposed by the administration.

One area where additional flexibility is possible is rate-setting. The new ratemaking system envisioned by the President's Commission has several potential virtues, including reduction in administrative burden and uncertainty about pending rate changes. However, it would also limit the opportunity for parties who might be

affected by rate changes to participate in the process, and severely curtail the amount of time available for evaluating the justification for above-inflation rate increases. Congress should carefully consider the views of mailers and other stakeholders on this issue.

The President's Commission recommended a new regime of public accountability by the Postal Service, including the establishment of a postal regulatory board vested with substantial expanded authority. The President's Commission also recommended that the Postal Regulatory Board have authority to hear and resolve a variety of complaints, thereby supplying a substantial amount of public protection not available under current law. I believe that providing regulators with authority to order appropriate remedial action when a complaint is found justified should limit the current concern that the Postal Service is not sufficiently accountable. The President's Commission also recommended that the new regulator be assigned oversight on the scope of both postal monopoly and its universal service obligation. The Commission provides a sound public policy rationale for assigning these functions, but criteria for defining the appropriate scope of Postal Service operations should be clarified. The PRC suggests that any legislation implementing postal reform should explicitly direct the regulatory body to consider preserving an adequate level of universal service as the principal criterion when reviewing the scope of the postal monopoly.

Last, Mr. Chairman, I cannot overemphasize the importance of ensuring that the reformed Postal Service become financially transparent, as the President's Commission recommended. In the Postal Rate Commission's view, establishing a financially transparent Postal Service is essential to assuring that it will function as a successful, performance-driven public service in the future. Furthermore, financial transparency—in the form of immediately accessible basic data about Postal Service finances and operation—will be an indispensable tool for implementing effective regulatory oversight of a transformed Postal Service.

Mr. Chairman, I believe we all recognize that fostering a financially self-sufficient Postal Service that will be able to cover all of its anticipated financial obligations is the primary challenge of postal reform. However, in moving to improve the Postal Service's "bottom line," care should be taken to assure the preservation of the Postal Service's honored tradition of binding the Nation together by making affordable services 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.

Mr. Chairman, thank you for the opportunity to present my views, and I look forward to working with you and the committee. And should any of you need anything from the Rate Commission, we would be most happy to oblige.

Mr. MCHUGH. Thank you very much, Chairman Omas.

[The prepared statement of Mr. Omas follows:]

TESTIMONY OF GEORGE A. OMAS
CHAIRMAN, POSTAL RATE COMMISSION
BEFORE THE SPECIAL PANEL ON POSTAL REFORM
OF THE COMMITTEE ON GOVERNMENT REFORM

January 28, 2004

Mr. Chairman, members of the Committee, thank you for providing me the opportunity to present testimony to the Committee on Government Reform's Special Panel on Postal Reform and Oversight. This hearing is for the purpose of discussing the need and prospects for comprehensive postal reform, with a focus on the five principles suggested as guides by the Administration.

The Postal Rate Commission (PRC) commends the Administration for bringing the issue of postal reform to the forefront of public debate by releasing its five principles for postal reform. We wholeheartedly endorse these principles and believe that the entire postal community owes the Administration a debt of gratitude for its timely effort. The Administration's postal reform initiative is a direct product of the exemplary work done by the President's Commission on the United States Postal Service (President's Commission) last year. The PRC believes that the President's Commission has done an extraordinary job of synthesizing a huge amount of information from diverse sources into a cogent and persuasive call for reform.

As I reviewed my materials on recent postal reform efforts, I came to see a distinct pattern. Starting with the efforts of Chairman McHugh almost eight years ago, there has been a gradual awakening to the potential benefits of modernizing the Postal Service. I think it is now evident that such modernization is essential. Furthermore, I think there is widespread agreement that legislation is necessary to facilitate modernization.

The Administration has called upon Congress to enact comprehensive postal reform legislation to ensure continuity in the effective operation of the nation's universal postal system. It sets forth five policy guidelines for achieving that objective, beginning with the Postal Service's implementation of corporate

"best practices" to meet its responsibilities and objectives. I wholeheartedly endorse the Administration's recommendation to introduce "best practices," but will leave it to the Postal Service, the General Accounting Office (GAO) and other reviewers to comment on the specifics of that recommendation.

My testimony will begin by reviewing the report of the President's Commission as it relates to the principles and basic policy choices it recommends. Following that, I will address each of the remaining four principles espoused by the Administration for guiding postal reform legislation. These are:

- Enhanced Postal Service flexibility, and its responsible exercise;
- Accountability, and the mechanisms for ensuring it;
- Financial self-sufficiency, and guaranteeing fairness to stakeholders; and
- Transparency, and its essential importance to effective postal reform.

FACTUAL AND POLICY BASES OF PRESIDENT'S COMMISSION'S RECOMMENDATIONS

In its report, the President's Commission addresses the subject of reconfiguring a national postal system with a decidedly uncertain future. The President's Commission finds that: "Universal postal service remains vital to the nation and its economy at the dawn of the 21st century." Report at vii. Largely on this ground, the President's Commission states its belief that the United States Postal Service "should remain an independent entity within the executive branch of the Federal government with a unique charter to operate as a self-sustaining commercial enterprise." *Id.* at ix. At the same time, however, it identifies significant challenges to maintaining viable universal service in the future. The report states:

> Unfortunately, the institution that delivers it is in significant jeopardy. Buffeted by the mounting costs of an inefficient

> delivery network and the popularity of electronic mail, the Postal Service has more than $90 billion in debts and unfunded obligations and an unstable financial outlook. Absent fundamental reforms, the risk of a significant taxpayer bailout or dramatic postage rate increases looms large.

Id. at vii.

The report identifies and discusses several practical obstacles to the continued successful operation of a universal mail service. These include:

- A long-term decline in the rates of volume growth of First-Class Mail and Standard Mail, exacerbated by the threat of diversion to cheaper electronic alternatives;
- Rising operating costs, resulting from an aging infrastructure and large employee base; and
- Accumulated debts and liabilities reaching "destabilizing" levels, which may only increase as expenses outpace the growth of operating revenues.

While the report notes that the Postal Service has made substantial progress in realizing cost savings through action under its Transformation Plan of April 2002, it anticipates that the Service may experience significant — and rapidly ballooning —deficits within a few years, even if stamp prices continue to rise with inflation.

In light of its findings on the current state and future prospects of the Postal Service, the President's Commission concludes that the nation faces a fundamental policy choice: to prepare to pay — either through taxation or postal rate increases — for increasingly dated and costly mail service, or to "permit an ambitious modernization that embraces proven business strategies, private-sector partnerships and new technologies to rein in costs aggressively and improve service." *Id.* at vii.

The President's Commission unequivocally recommends the latter course. In addition to adopting corporate "best practices," the Commission recommends

that the Postal Service introduce transparency to measure and report information on its product costs and performance; be afforded enhanced flexibility to reduce costs, set rates, and adapt to a dynamic marketplace; be made accountable through the exercise of strong independent oversight in order to protect consumer welfare and universal mail service; and exercise its newfound flexibility to become financially self-sufficient and cover all its obligations.

The Postal Rate Commission fully supports these recommended initiatives for improving the likelihood that the nation will continue to receive superior postal service in the coming decades. It also stands ready to fulfill whatever role may be found appropriate and necessary for achieving that goal. The remainder of my testimony today explores policy and practical considerations likely to arise in the process of implementing the recommendations made by the President's Commission.

ENHANCED POSTAL SERVICE FLEXIBILITY AND ITS RESPONSIBLE EXERCISE

The President's Commission recommends that the Postal Service's Board of Directors and senior management be afforded greater flexibility to manage without limitations imposed by statutory constraints. Specifically, it recommends that: (1) Postal Service management should be given flexibility to implement corporate best practices; (2) the Service should be allowed to set rates within limits established by a new Postal Regulatory Board (Regulatory Board or PRB); (3) the Service should no longer be subject to the $3 billion sub-limits on annual borrowing for capital and operating needs; and (4) the Service should be able to retain earnings subject to limits established by the PRB. *Id.*, Appendix C, Recommendation C-2. 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 Regulatory Board with a clear mandate to protect the public interest.

I endorse the balanced approach to enhanced Postal Service flexibility recommended by the President's Commission. However, I believe that it is appropriate for Congress to consider how the Service may appropriately exercise its newfound flexibility in the future, especially with regard to ratesetting.

The President's Commission contemplates that, following a PRC proceeding to establish "baseline" rates, the Postal Service would be afforded pricing freedom within broad constraints. Rates for non-competitive (monopoly and market-dominant) products 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. Rates for competitive services would be required to recover all their allocable costs to assure that cross-subsidies from non-competitive products do not occur.

While the President's Commission correctly anticipates that the Postal Service is likely to find this new pricing freedom useful, it does not offer specific public policy guidance on how its benefits should be distributed among ratepayers. Current postal law directs the PRC to consider a variety of pricing factors in recommending rate levels — for example, "the educational, scientific, and informational value to the recipient of mail matter[.]" [39 U.S.C. § 3622(b)(8).] If a flexible pricing regime is to be adopted, Congress may wish to consider articulating the public policy considerations that are appropriate for guiding the Postal Service's discretionary pricing decisions.

MECHANISMS OF ACCOUNTABILITY AND PUBLIC RESPONSIVENESS

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 Regulatory Board's authority would encompass not only ratemaking matters such as appropriate cost allocations, the prevention of cross-subsidies, and extraordinary (above inflation) 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 PRB 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 President's 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, strong regulatory oversight is a crucial element of comprehensive postal reform. Further, 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 potentially competing objectives.

A. New System of Rate Regulation

The President's Commission recommends that the Regulatory Board, 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 recovery, ensuring that its costs are appropriately distributed across its competitive and

non-competitive products and services. The PRC's institutional experience confirms the importance of this analytical function. Such analysis is necessary for verifying that cross-subsidies between services are not occurring.

The President's Commission contemplates that 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 President's Commission views it as an important incentive to make the Postal Service manage itself more efficiently.

After rates have been established in a baseline case, the President's Commission suggests that no major rate litigation would be necessary. It proposes that all rate matters before the Postal Regulatory Board be limited to written submissions and be conducted in 60 days. The PRB would then direct the Postal Service to implement whatever rate changes are found appropriate.

This system has several potential virtues. It would not be burdensome to either mail users or the Postal Service, and would rapidly resolve the potential uncertainty of "proposed" rate changes. However, because it would limit the opportunities of parties who might be affected by rate changes to participate in the process, and also severely curtail the amount of time available for evaluating the justifications for change, Congress should hear and carefully consider the views of mailers and other stakeholders on this recommended change.

B. Postal Monopoly and Universal Service

Another essential responsibility of the Regulatory Board involves the recommended oversight of both the scope of the Postal Service's monopoly and that of its universal service obligation. The President's Commission report recommends that the PRB'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 provides 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, a 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 implementing 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.

Under the President's Commission's recommendations, the Regulatory Board would also exercise two new forms of oversight regarding services the Postal Service provides. First, the PRB would monitor the types of products and services offered by the Service to ensure it does not exceed its core mission. Second, the Regulatory Board would review changes in service standards proposed by the Postal 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 President's 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. Currently, the Postal Service exercises broad responsibility for defining the nature of universal service and the scope of its monopoly. This recommendation of the President's Commission would transfer this governmental responsibility from the operator of the postal system to the regulatory agency that would oversee the operator. Transferring these functions as recommended by the Commission involves issues of national postal policy worthy of congressional consideration.

C. Expanded Authority to Hear Complaints

The President's Commission recommends that the Postal Regulatory Board hear and resolve a variety of complaints from the public. The PRB 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 Regulatory 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.)

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 PRB 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 President's 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.

The PRC suggests that it would be consistent with the goals of accountability and public policy oversight to allow the Regulatory 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 President's 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.

FINANCIAL SELF-SUFFICIENCY AND FAIRNESS TO STAKEHOLDERS

The President's Commission recommends that the Postal Service, reconfigured to operate with enhanced management flexibility, become financially self-sufficient and thereby cover all its anticipated obligations. In this respect, the Commission recommends retention of a prominent policy feature of the 1970 Postal Reorganization Act.

Recognizing the challenges this goal presents for the future, the President's Commission recommends measures it believes will contribute to ensuring future financial self-sufficiency. These include a more flexible pricing regime together with various strategies for improving the Postal Service's "bottom line"— optimizing its mail processing and distribution infrastructure, improving its management of real estate assets and procurement, partnering with the private sector to realize additional operating savings, and developing a workforce appropriate to fulfilling its universal service obligation.

Obviously, Congress must carefully consider and weigh all of these recommendations in developing postal reform legislation. In doing so, 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.

At the same time, deliberations on the various measures recommended by the President's Commission should anticipate and provide for the needs and interests of the many stakeholders in the postal system. Public acceptance of needed changes is likely to be strongest if all potentially affected interests are given a "seat at the table" to express their concerns and participate in fashioning an acceptable final product. In addition to considering proposals on their merits, I also believe care should be taken to provide against unintended and unforeseen adverse consequences of their operation.

The system of rate regulation recommended by the President's Commission would appear to raise several such concerns. 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. For this reason, in the PRC's view, the regulator should also have authority to ensure that appropriate levels of service are maintained.

Furthermore, should the Postal Service seek to raise rates for non-competitive mail above the applicable inflation-based cap, there may be sound policy reasons for allowing captive customers to do more than just submit written protests, as proposed. The President's Commission evidently 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 past general rate 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.

GUARANTEEING POSTAL SERVICE TRANSPARENCY

Lastly, I cannot overemphasize the importance of ensuring that a reformed Postal Service become financially transparent, as the President's Commission recommends. In the PRC's view, establishing a financially transparent Postal Service is essential to assuring that it will function 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 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 proposed rate changes and complaints within the recommended timeframe.

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 expeditious review. This could encompass both information the Postal Service has on hand for its own operational purposes and other specialized data necessary for regulatory review. For this reason, it is the PRC's 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.

On January 6, 2004 the Chairman of the Postal Service's Board of Governors reported significant progress in ongoing efforts to enhance the Postal Service's financial reporting, and announced an intention to voluntarily release additional information consistent with applicable Securities and Exchange Commission reporting requirements. I commend Chairman Fineman, and the Postal Service as an institution, for this initiative, and encourage them to continue their efforts to increase the Service's financial transparency. Further, in deliberating on postal reform legislation, I urge Congress to consider adoption of provisions that would require the Postal Service to continue to make progress on implementing financial and operational transparency.

Mr. Chairman, thank you for the opportunity to present my views on the Administration's recommendations regarding the principles of postal reform. I would be pleased to answer any questions.

Mr. MCHUGH. And I would be remiss if I didn't know you were joined by two of your current colleagues, Tony Hammond and Dana Covington, seated behind you, also members of the Rate Commission. As you were giving this—and by the way, he did summarize; this was a 14-page written statement, I know, I have seen it, and I appreciate that. But as you were going through those, I couldn't help but wonder if Ed Gleiman would agree with you, and I am watching to see if the former chairman of the PRC nodded or did anything. He is stone cold. He gave no indication at all. So I will have to talk to him directly about it. But I appreciate your comments.

Last, and certainly not least, a gentleman who, as I said, is no stranger to this Hill let alone this committee, particularly the former subcommittee and now panel, and his organization has been absolutely outstanding in providing the Congress with dispassionate, sometimes very cold and hard facts, but cold and hard facts we absolutely need. And our efforts with respect to postal reform would have been far less revealing and helpful had it not been for the input of his good people and under his leadership. And we are looking forward today to the comments and the appearance once again of the Comptroller General of the United States, the Honorable David Walker. David, welcome.

STATEMENT OF DAVID M. WALKER, COMPTROLLER GENERAL OF THE UNITED STATES

Mr. WALKER. Thank you, Mr. Chairman and members of the special committee. It is a pleasure to be before you to talk about postal reform and transformation.

GAO believes that comprehensive postal reform is necessary. As you know, Mr. Chairman, we put postal transformation on our high-risk list in 2001, and the reason we did that was because we believed that the current postal business model is not sustainable in the 21st century. We were pleased that the President appointed a special commission, which we had recommended, and that the Commission agreed with our bottom-line conclusion.

I would also like to note for the record that we believe that much progress has been made, and there have been many positive developments under Chairman Fineman's and Postmaster General Potter's leadership during the last 2 years. Those are encouraging developments. At the same point in time, many, many challenges remain. And, clearly, one of the things that has to be done is that Congress is going to have to help in order to ultimately achieve the necessary transformation that is required.

We agree with the administration's five key principles and, I might add, with the sixth principle that the Postmaster General just added here that is outlined in their statement. The Commission's report provided many valuable insights and recommendations. We agree with most of them, but not all of them.

One key challenge for the Congress in developing postal reform legislation is to draw clear distinctions among those areas involving public policy issues where statutory guidance would be appropriate versus those areas that should be the purview of a regulatory body and those that should be within the authority of postal management and its governing body. One clear example of this has to do

with the public policy issue that Congress needs to address dealing with defining the appropriate mission and role for the Postal Service in the 21st century, including how universal, affordable Postal Service should be defined given 21st century realities.

Where the distinction between regulatory, management and the Board's responsibilities should be drawn is a more difficult and controversial issue, but a necessary undertaking. Although we have not taken a position on the proposed price cap system or any particular rate-setting model, I do have some thoughts on one possible approach to this if you would like to address it in a Q and A session.

In the governance area, we share the concerns raised by the Postal Service regarding the Presidential Commission's recommendations on the appointment process for Board members. Namely, that the proposed process could result in the politicization of the Board.

Transparency is key to ensuring appropriate accountability in any area, including the Postal Service. In this regard, the regulatory body can play an important role in ensuring adequate financial and performance reporting, cost allocation, and data collection. Postal management does need additional flexibility to meet its transformation objectives by implementing best practices to achieve cost savings and efficiency gains, many examples of which were suggested by the Presidential Commission.

One area where the Service has indicated a need for additional flexibility, and we agree, is rationalizing its infrastructure and work force. At the same point in time, they have disagreed with the idea of creating a special commission, such as a BRAC-type commission, for rationalizing its infrastructure. That was recommended by the President's Commission as well as by GAO as one possible alternative. If the Postal Service wants to do this on its own, we believe it is imperative that there be a comprehensive and transparent plan for rationalizing the infrastructure and the workforce, as well as policies and procedures. While much can be done and has been accomplished during the last few years without such a comprehensive and transparent plan, we believe the heavy lifting will not be able to be done without such a comprehensive or transparent plan.

In the human capital area, we believe that Congress has a rare opportunity to address several key issues, including who should have the responsibility for military service pension costs, funding issues relating to the Service's pension and retiree health obligations, as well as the escrow fund that was established last year as part of pension legislation. The Service has made some very good points regarding the need to make changes in its workers' compensation benefits as well. Another difficult issue that needs to be addressed is the issue of pay comparability, where we suggest that some additional statutory guidance in this area might be in order. Regarding the Service's retiree health benefits, we are pleased that the Service has proposed prefunding some of its retiree health benefits obligation. In our view, this approach represents a better balancing of interests between current and future ratepayers, given the demographic profile of the Service. We do have some concerns

about how it would be implemented, but conceptually we think it has merit.

Finally, we applaud Chairman Fineman's emphasis on improved financial transparency, but we also agree with the Treasury Department that serious consideration should be given to the proper accounting and reporting of retiree health obligations in the Postal Service's financial statements. In summary, comprehensive pension reform is necessary. Such reform should be designed to attain a modern, effective, and sustainable business model for the Postal Service. It needs to provide reasonable flexibility to management, appropriate transparency to the public, and adequate accountability for all parties involved.

And the last thing, Mr. Chairman, I think it is important to note that while nobody likes rate increases, we should not measure success in the Postal Service by how long we are able to delay rate increases. Some rate increases are inevitable. In fact, delaying rate increases in certain circumstances may be imprudent in light of the demographic profile of the Postal Service. If the result of a delay is to preposition more significant and dramatic rate increases in the future in the face of increasing competition, that is not necessarily success. And so I think that we have to recognize that there is a balancing of interests that has to occur and that ultimately achieving a universal, affordable Postal Service that is sustainable is of critical importance.

Thank you, Mr. Chairman.

Mr. MCHUGH. Thank you, General Walker.

[The prepared statement of Mr. Walker follows:]

United States General Accounting Office

GAO

Testimony

Before the Special Panel on Postal Reform and Oversight, Committee on Government Reform, House of Representatives

For Release on Delivery
Expected at 2:00 p.m. EST
Wednesday, January 28, 2004

U.S. POSTAL SERVICE

Key Elements of Comprehensive Postal Reform

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

GAO-04-397T

January 28, 2004

GAO
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Highlights

Highlights of GAO-04-397T, a testimony before the Special Panel on Postal Reform and Oversight, House Committee on Government Reform

U.S. POSTAL SERVICE

Key Elements of Comprehensive Postal Reform

Why GAO Did This Study

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

GAO has testified that Congress should enact comprehensive postal reform legislation that would clarify the Postal Service's (the Service) mission and role; enhance governance, transparency, and accountability; improve regulation of postal rates and oversight; help to ensure the rationalization of the Service's infrastructure and workforce; and make needed human capital reforms.

The administration has also supported postal reform, outlining guiding principles intended to ensure that the Service: implements best practices with a governing body equipped to meet its responsibilities; enhances transparency of timely and accurate data on postal costs and performance; provides greater flexibility for the Service to meet its customer obligations; ensures accountability through appropriate independent oversight; and keeps the Service financially self-sufficient, covering all of its obligations. GAO was asked to discuss comprehensive postal reform in light of these principles.

This testimony is largely based on prior GAO reports and testimonies.

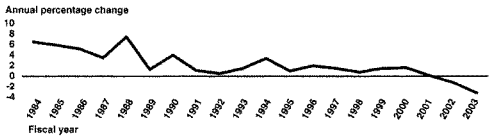
www.gao.gov/cgi-bin/getrpt?GAO-04-397T.

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

What GAO Found

GAO believes that comprehensive postal reform is urgently needed. The Service achieved notable success in fiscal year 2003, but this respite is likely to be short-lived. The outlook is for continuing declines in the core business of First-Class Mail, while some key costs are rising and productivity gains are likely to slow.

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



Source: Postal Service.

Key postal reform issues that need to be addressed are:

The Service's Mission and Role as a Self-Financing Federal Entity
The Service has a broadly defined mission that enables it to engage in unprofitable and costly endeavors. In our view, the time has come for Congress to clarify the Service's core mission and ensure continuity across changes in its management. Key issues include what should be the scope of the postal monopoly, and should the Service retain its regulatory functions.

Governance, Transparency, and Accountability Mechanisms
Better governance, transparency, and accountability mechanisms are needed. Qualification requirements are too general to ensure that board appointees have the experience needed to oversee a large business-like operation. Enhanced transparency and accountability mechanisms are also needed for financial and performance information, such as reporting requirements.

Flexibilities and Independent Oversight
The Service needs additional flexibilities so it can generate needed revenues, contain costs, and provide quality service. Major changes to the rate-setting structure are needed to enhance flexibility, encourage greater cost allocation, provide better cost data, and strengthen independent oversight. Also, current legal and other constraints serve to limit the Service's ability to rationalize its infrastructure and workforce, including closing unnecessary post offices.

Human Capital Reforms, Including Pension, Benefit, and Escrow Issues
Outstanding human capital issues include the Service's responsibility for pension costs related to military service, funding the Service's significant obligations for retiree health benefits, and determining what action to take on the escrow account established as a result of the enactment of P.L. 108-18. Other key areas for reform include workers' compensation and pay comparability.

Chairman McHugh and Members of the Special Panel:

I am pleased to be here today to participate in this hearing on postal reform. In my testimony today, I will focus on (1) the need for postal reform and (2) key areas for comprehensive postal reform. Recently, the U.S. Postal Service (the Service) has gained some financial breathing room primarily because legislation enacted in April 2003 (P.L. 108-18)[1] has reduced the Service's payments for its pension obligations. The Service's net income in fiscal year 2003 was a record $3.9 billion, of which about $3 billion was the result of this legislation. In addition, the Service reported that it has made notable progress in its cost-cutting efforts. In fiscal year 2003, the Service downsized its workforce by 27,000 employees, increased its productivity for a record fourth consecutive year, and achieved $1.1 billion in cost reductions. As a result, the Service reduced its debt by $3.8 billion in fiscal year 2003 to $7.3 billion at the end of the fiscal year. The Service also maintained high levels of customer satisfaction and timely delivery of collection-box First-Class Mail, setting new records in each of these areas. The Service is justifiably proud of these achievements.

However, as the Service has recognized, its respite is likely to be short-lived, given increasing competition and the Service's formidable financial, operational, and human capital challenges. As the President's Commission on the United States Postal Service (the presidential commission) noted, the nation's communications, technology, and delivery markets have seen vast changes since the Service was created by the Postal Reorganization Act of 1970.[2] New types of electronic communications include the use of e-mail, wireless technology, and electronic bill payment services. These technological advances appear to have placed First-Class Mail volume in the early stages of a long-term decline. In addition, the Service faces increased competition from private delivery companies, some of which have established national ground delivery systems and a national network of retail facilities. 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

[1]The Postal Civil Service Retirement System Funding Reform Act of 2003, Pub. L. No. 108-18, 117 Stat. 624.

[2]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).

universal mail service can be sustained over the long term with a self-financing public institution.

Recent developments strengthen our view that enactment of postal reform legislation is urgently needed so that the Service can achieve a successful transformation to modernize itself and continue as a viable provider of universal postal service in the 21st century. To summarize:

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

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

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

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

- *Declining capital investment:* The Service's capital cash outlays declined from $3.3 billion in fiscal year 2000 to $1.3 billion in fiscal year 2003, which was the lowest level since fiscal year 1986, and far below the level of the late 1990s, when the Service spent more than $3 billion annually. Capital cash outlays are budgeted to increase to $2.4 billion in fiscal year 2004, but this level may not be sufficient to enable the Service to fully fund its capital investment needs. In the longer term, it is unclear what the Service's needs will be to maintain and modernize its physical infrastructure, as well as how these needs will be funded.

- *Renewed difficulties in substantially improving postal productivity:* The Service's productivity increased by 1.8 percent in fiscal year 2003 but is estimated to increase by only 0.4 percent in fiscal year 2004. In the absence of mail volume growth, substantial productivity increases will be required to help cover cost increases generated by rising wages and benefit costs and to mitigate rate increases.

- *Significant financial liabilities and obligations:* Despite the passage of legislation that reduced the Service's pension obligations, the Service has about $88 billion to $98 billion in liabilities and obligations that include $47 billion to $57 billion in unfunded retiree health benefits. Under the current pay-as-you go system, the Service may have difficulty financing its retiree health benefits obligation in the future if mail volume trends continue to impact revenues while costs in this area continue to rise. The Service has recently proposed two options to Congress so the Service could prefund this obligation to the extent that it is financially able.

- *Uncertain funding for emergency preparedness:* The Service requested $350 million for emergency preparedness for fiscal year 2004, which it did not receive, and $779 million for fiscal year 2005. If the money is not appropriated, funding for this purpose may have to be built into postal rates.

- *Challenges to achieve sufficient cost cutting:* The Service achieved additional cost cutting to compensate for below-budget revenues in fiscal year 2003. Despite this progress, in the longer term it is unclear whether continued cost-cutting efforts can offset declines in First-Class Mail volume without impacting the quality of service.

In view of the Service's continuing financial, operational, and human capital challenges, as well as trends that increase the urgency of making rapid progress in transforming its organization, we believe that Congress should enact comprehensive postal reform legislation that includes the

Service's overall statutory framework, resolution of issues regarding the Service's pension and retiree health benefits obligations, and whether there is a continued need for an escrow account. We are pleased that the administration has engaged with Congress and other stakeholders on these important issues, and agree with the administration's principles for postal reform.[3] We also believe that the findings and recommendations of the presidential commission's report made a valuable contribution to assist Congress, the administration, the Service, and other stakeholders in considering the actions needed to transform the Service to a more high-performing, results-oriented, transparent, and accountable organization. My testimony, based on our prior reports and testimonies[4] and our continuing work in this area,[5] will address the need for postal reform and the key areas for comprehensive postal reform, including

- clarifying the Service's mission and role by defining the scope of universal service and the postal monopoly and clarifying the role of the Service in regard to competition;
- enhancing governance, transparency, and accountability by delineating public policy, operational, and regulatory responsibilities, as well as defining appropriate transparency and accountability mechanisms;
- improving flexibilities and oversight by balancing increased postal flexibility with an appropriate level of independent oversight and addressing selected legal and other constraints that limit the Service's

[3]http://www.treas.gov/press/releases/js1044.htm.

[4]U.S. General Accounting Office, *U.S. Postal Service: Bold Action Needed to Continue Progress on Postal Transformation*, GAO-04-108T (Washington, D.C.: Nov. 5, 2003); *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.: January 2003); *U.S. Postal Service: Moving Forward on Financial and Transformation Challenges*, GAO-02-694T (Washington, D.C.: May 13, 2002); *U.S. Postal Service: Deteriorating Financial Outlook Increases Need for Transformation*, GAO-02-355 (Washington, D.C.: Feb. 28, 2002); *U.S. Postal Service: Financial Outlook and Transformation Challenge;* 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).

[5]We did not independently verify any Postal Service data, although data from its financial statements were audited by an independent auditor. Some other data, such as data on mail volumes and costs, were produced by data systems that have been reviewed by the Postal Rate Commission, by stakeholders participating in rate cases, and by the 1999 Data Quality Study. See A.T. Kearney, *Data Quality Study* (Alexandria, Virginia: Apr. 16, 1999).

ability to rationalize its infrastructure and workforce; and

- making needed human capital reforms such as determining the Service's responsibility for pension costs related to military service, funding retiree health benefits, and determining what action to take on the escrow account established in recent pension legislation, deciding whether postal workers' compensation benefits should be on par with those in the private sector, and clarifying pay comparability standards.

The Need for Comprehensive Postal Reform Legislation

Our conviction, shared by the presidential commission, the Service, the administration, and others, is that postal reform is needed. The status quo has not produced satisfactory results and the temporary surpluses generated by P.L. 108-18 are unsustainable. Incremental steps toward postal transformation cannot resolve the fundamental and systemic issues associated with the Service's current business model. 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. Fundamental changes will need to be made to the Service's business model, and the legal and regulatory framework that supports it, to help assure the Service's long-term financial viability. Now that the presidential commission has finished its work, the time has come for Congress to act. Structural issues contributing to the need for postal reform include the following:

- *Uncertain financial future:* The Service is intended to be self-supporting through postal revenues. However, as the presidential 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 over $85 billion in financial liabilities and obligations over the past three decades. These liabilities and obligations include large unfunded obligations for retiree health benefits, workers' compensation liabilities, remaining pension obligations, and debt. Given the Service's demographics and current health care trends, the costs and obligations related to retiree health benefits are expected to continue rising at a rapid rate. These growing obligations will increase financial pressure on the Service at a time when revenues from First-Class Mail are expected to continue to decline.

- *Difficulty financing capital needs:* In recent years, as the Service's debt level neared its $15 billion cap, the Service found it problematic to obtain adequate financing for capital needs and thus curtailed capital spending. Recently enacted pension legislation has resulted in an increase in cash flow, and the Service plans to increase capital

spending for fiscal year 2004. However, in the longer term, it may be difficult for the Service to obtain adequate funds to address its capital needs, including modernizing its aging network of postal facilities, without significantly increasing rates or debt. An additional potential source of funding is the disposition of surplus real estate, because the Service is allowed by law to retain all revenues received from the disposition of postal assets. Although the current market value of the Service's portfolio is unknown, its book value is approximately $15 billion.

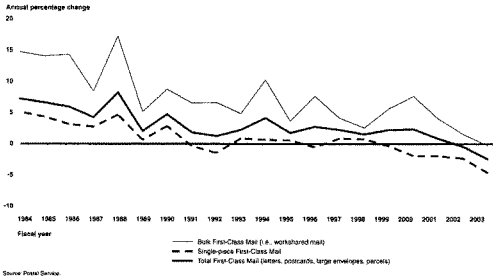
- *Limited incentives for success:* The current legal framework, which was designed to help the Service fulfill universal service mandates, does not provide the same types of incentives that apply to the private sector. Under the statutory break-even mandate and postal monopoly, the Service does not have the profit motive or direct competition (in letter mail) like the private sector does. In addition, the rate-setting structure has allowed the Service to cover rising costs by increasing rates. Moreover, 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, limiting incentives for cutting costs and improving productivity. In this regard, a limited retained earnings provision could enable the Service and its employees to benefit from whatever cost reductions are achieved.

Despite the above, the Service has achieved success in reducing total work hours and downsizing its workforce by over 74,000 employees over the past 3 fiscal years, which has helped the Service contain its costs. However, cost cutting is likely to achieve diminishing returns under the current structure, which restricts the Service's flexibility and provides limited incentives. Thus, postal reform is needed to enhance incentives and enable the Service to achieve major advances in postal productivity and continued cost reductions. Such advances may be achieved through continuing automation as well as realignment of the Service's processing and retail networks.

As previously noted, the likelihood of declining First-Class Mail volume is another key impetus for postal reform. Its rate of growth has been in long-term decline since the 1980s. First-Class Mail can be divided into two categories that are both declining in volume: (1) single-piece mail, such as letters, which is sent at the rate of 37 cents plus 23 cents for each additional ounce; and (2) bulk mail, which receives discounts for worksharing activities performed by mailers (see fig. 1). The single-piece mail includes remittance mail, which is impacted by diversion to other forms of payment, such as automatic deductions from bank accounts,

automatic charges to credit cards, and other electronic payments. The bulk mail includes mailings of bills and statements, and advertising mail. Single-piece First-Class Mail volume declined by a record 5.4 percent in fiscal year 2003, while bulk First-Class Mail volume declined by 1 percent—the first such decline since worksharing discounts were implemented in fiscal year 1976.

Figure 1: First-Class Mail Volume Growth, Fiscal Years 1984 through 2003



Source: Postal Service.

First-Class Mail generates more than half of the Service's revenue and covers more than two-thirds of its institutional costs. Standard Mail volume is growing, but it makes a smaller per-piece contribution than First-Class Mail and its volume is considered more price sensitive to rate increases. Parcel Post volume is also growing, but not enough to offset declines in Priority Mail. Periodicals mail is priced at cost, and other sources of Service revenue make a relatively small contribution to its institutional costs. Thus, the loss of contribution from declining First-Class Mail volume is difficult to recover from other classes of mail.

Looking ahead, a report prepared for the presidential 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.[6] The rapid

[6]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, California: May 2003).

diffusion of computer, Internet, and broadband 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. These trends point to the strong potential for further 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.

If the Service's core business of First-Class Mail continues to decline, it will face the formidable challenge of maintaining affordable universal postal service by growing revenues, significantly cutting costs, or reducing service standards. 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 infrastructure and workforce costs associated with having to deliver mail to over 1.5 million new addresses every year. Thus, maintaining the quality and affordability of postal services would likely require dramatic improvement in the Service's efficiency. In order to do so, the Service will need to become a much leaner and more flexible organization and rightsize its processing and retail networks and its workforce.

More significant and frequent rate hikes are also likely to be needed to cover the costs of benefits that are being earned by current employees and financed under existing cash-based accounting and rate-setting methods. One of the key reform challenges facing Congress and the Service is the funding of the Service's financial liabilities and obligations, including unfunded retiree health benefits, workers' compensation benefits, and Civil Service Retirement System (CSRS) pension obligations. Although recent legislation addressed how the Service will cover its CSRS pension obligations over a 40-year period, 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 payments on its retirees' health insurance premiums are expected to continue rising until about 2040.

Congress is currently reviewing the Service's retirement-related obligations. We believe that it would be prudent for the Service to address the unfunded obligations today, in a manner that is fair and balanced for both current and future ratepayers. In response to the requirement in the Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L.108-18) that the Service report on how it proposes to use the pension

"savings" resulting from the act, the Service proposed to prefund at least a portion of its retiree health benefits obligation. We found that although this proposal would result in marginally higher postal rate increases, at least in the short term, it strikes a reasonable and equitable balance between current and future ratepayers, and addressed one of the Service's substantial future obligations. On a related matter, we recommended that Congress repeal the escrow requirement established by P.L. 108-18 after receiving an acceptable plan from the Service describing how it intends to rationalize its infrastructure and workforce and is confident that the Service is making satisfactory progress on transforming itself into a more efficient organization and implementing its other transformation goals.[7] This recommendation and related considerations, including responsibility for military service pension costs, are discussed further in this statement. Taken together, consideration of the escrow requirement, postal reform, and the Service's retiree health benefits obligation represents a rare opportunity to address the Service's long-term financial viability.

Major Elements Needed for Comprehensive Postal Reform

We and the presidential commission have reported that universal postal service is at risk and that reform is needed to minimize the risk of a significant taxpayer bailout or dramatic and more frequent postal rate increases. We have testified that Congress should enact comprehensive postal reform legislation that would clarify the Service's mission and role; enhance its governance, transparency, and accountability; balance enhanced flexibility and oversight to improve regulation of postal rates; help to ensure the rationalization of the Service's infrastructure and workforce; and make needed human capital reforms. The administration has also supported postal reform and outlined guiding principles to ensure that the Service: implements best practices with a governing body equipped to meet the responsibilities and objectives of an enterprise of its size and scope; enhances transparency of timely and accurate data on postal costs and performance; provides greater flexibility for the Service to meet its obligations to customers in a dynamic marketplace; ensures additional accountability through appropriate independent oversight; and keeps the Service financially self-sufficient, covering all of its obligations. In the following sections of this testimony, I discuss comprehensive postal reform in light of these principles.

[7]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).

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. As the presidential commission recognized, the nation's postal laws that established the Service in the early 1970s 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.[8] The Service's ill-fated ventures were also questioned by some postal stakeholders as unfair competition, since they were cross-subsidized by a 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 presidential 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. Key questions in this area include the following:

- How should universal postal service be defined in the 21st century?
- 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?
- 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 its regulatory responsibilities and law enforcement functions?

[8]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); and *U.S. Postal Service: Development and Inventory of New Products*, GAO/GGD-99-15 (Washington, D.C.: Nov. 24, 1998).

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.[9] 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. Narrowing or eliminating the monopoly could increase consumer choice and provide incentives for the Service to become more effective and efficient. For example, in the competitive parcel market, 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.

Another issue is whether the 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.[10] The presidential commission has recommended separating these functions so that the Postal Service cannot define and regulate the scope of its own monopoly. As the presidential commission noted, it is a fundamental premise of American justice that parties that administer laws should not have a financial interest in the outcome. Questions relating to the postal monopoly include the following:

- 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?
- Should the Service continue to have the power to define and regulate its own statutory monopoly, including use of the suspension process?
- Should a regulatory body have authority to redefine and narrow the postal monopoly and the mailbox monopoly? If so, should a clear statement of congressional intent be provided to guide regulatory decisions, or should the regulator have unfettered discretion to

[9]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).

[10]The Service has used its regulatory power to further define 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 C.F.R. § 310.1(a)) as well as regulations specifying access to mailboxes (Domestic Mail Manual, D041 and P011.2.2).

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 the delivery companies 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?

The Need for Enhanced Governance, Transparency, and Accountability Mechanisms

In our view, the Service must have greater flexibility to operate in a businesslike fashion, but with this latitude comes the need for enhanced governance, transparency, and accountability mechanisms. Managerial accountability must come from the top, with the Service governed by a strong, well-qualified corporate-style board that holds its officers responsible and accountable for achieving real results both currently and over time. In addition, despite recent improvements, we continue to be concerned that additional transparency mechanisms be implemented to enhance the Service's accountability for financial and performance results.

Governance Issues

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 an appropriate guide for governance. Having a well qualified, independent, adequately resourced, and accountable board is critical for a major federal institution with annual revenues approaching $70 billion and almost 830,000 employees at the end of fiscal year 2003. We agree with the presidential commission that the Service's legacy governance structure 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. In this regard, one issue is what statutory qualification requirements are appropriate for the board to ensure that it has the kind of expertise necessary to oversee a major government business.

Another major issue 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. Specifically, how should the Service's governing

board, along with top management, be held accountable? The presidential commission recommended that the Postal Rate Commission (PRC) be replaced with a newly created regulatory board endowed with broad public policy responsibilities as well as broad mandates and authority for accountability and oversight. These recommendations raise fundamental questions, including the following:

- Who should make certain 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 can 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? How should it be structured to preserve its independence from political manipulation 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?

Enhancing Transparency and Accountability of Financial and Performance Information

A key element of postal reform will be the statutory reporting requirements needed to ensure transparency and accountability of financial and performance information. The Service remains a public institution with a monopoly on providing vital postal services to the nation. Hence, appropriate transparency is needed so that stakeholders are well apprised of the Service's financial situation and performance and understand how future results may be affected by impending events, so that changes do not come as a surprise to those responsible for or impacted by its performance.

The Service has made recent progress in this area, but it recognizes that further progress should be made. Enhanced transparency will be essential for stakeholders to better understand the Service's financial situation and performance results, conduct independent oversight, and hold

management accountable.[11] In addition, enhanced reporting will be even more critical if the Service obtains greater flexibility to set postal rates in a streamlined manner that relies on rapid verification of compliance. A key issue is whether statutory change is needed to enhance the level of transparency that the Service must provide. We were pleased the Service has recently taken steps to enhance its financial reporting. The Chairman of the Service's Board of Governors also recently indicated that the Service would make further enhancements along the lines of some SEC reporting requirements. In our view, 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 Service, or giving a regulatory body authority in this area.

In addition, there are areas where stakeholders still have little information, such as the Service's financial needs for maintaining and modernizing its infrastructure, and the true market value of the Service's vast real estate holdings. Further, we 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 monopoly. The Service's customers have a right to know what they are getting for their money, particularly captive customers with few or no alternatives to using the mail. Information about service quality would become even more important if the Service obtains more flexibility and incentives to cut its costs. Accordingly, the presidential commission recommended that a regulatory body be required to prepare a comprehensive annual report assessing the 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.

[11]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).

Key questions related to transparency and accountability include the following:

- What transparency of the Service's financial and performance results is appropriate for oversight and accountability? What mechanisms should be established to facilitate and ensure adequate transparency?
- What transparency and accountability mechanisms are needed to prevent unfair competition and inappropriate cross-subsidization?
- Should the Service comply, either on a voluntary basis or through a statutory requirement, with major Securities and Exchange Commission (SEC) reporting requirements?

Flexibilities and Independent Oversight

Giving the Service greater flexibility to operate in a businesslike manner also would require enhanced oversight by an independent regulatory body endowed with sufficient authority and resources, as well as continued congressional oversight. Current law mandates independent review of postal rates and has the laudable goals of protecting postal customers against undue discrimination, restricting cross-subsidies, and ensuring due process. However, the current rate-setting structure is adversarial, lengthy and expensive. It also serves to significantly limit the Service's rate-setting flexibility while providing poor incentives for appropriate cost allocation. In addition, the Postal Rate Commission (PRC) has limited authority, particularly in the areas of cost allocation and ensuring the quality of the supporting data. Improvements in the rate-setting area will be a fundamental component of postal reform legislation. Furthermore, the Service faces legal and other constraints that limit its flexibility to rationalize its infrastructure and workforce. Legislative reforms are needed in this area as well.

More Flexibility and Enhanced Oversight Needed in Rate-Setting Area

As long as the Service remains a federal entity protected by the postal monopoly, its ability to compete with the private sector should be balanced with appropriate oversight and adequate legal standards to ensure fair competition between the Service and private competitors. Clear lines of authority in this area must be established if the rate-setting process is to be streamlined and sped up. A key issue for Congress to consider is 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. Key shortcomings of the current rate-setting structure include the following:

- *Adversarial, burdensome, and lengthy rate-setting proceedings.* Statutory requirements for rate and classification cases impose a litigious, costly, and lengthy rate-setting process that can delay needed new revenues by more than a year. Because the law enables any interested party to participate, most changes require a major proceeding that places the Service in an adversarial relationship with its major customers and at a distinct competitive disadvantage. Rate cases tend to pit the Service and postal stakeholders against each other, since the zero-sum nature of the break-even requirement provides powerful incentives for parties to attempt to shift postal costs in ways that serve their self-interests. 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, makes it difficult for smaller stakeholders to effectively participate. Statutory rules against ex parte communications help to preserve due process and fairness, but also make it difficult for experts to constructively discuss technical issues and resolve problems as they arise.

- *Unresolved, recurring disputes.* The current rate-setting structure, which seeks to assure all parties due process, enables them to repeatedly raise issues that have previously been considered. The Service has a unique opportunity to repeatedly raise issues by building them into its initial rate proposals. For many years, cost allocation issues have been debated and are frequently a key reason why rate cases are so lengthy and litigious, since their disposition can directly affect rates. Although interested parties should have an opportunity to participate in rate cases, the need to address complex cost allocations in every rate proceeding is inconsistent with having a streamlined rate-setting process that swiftly resolves complaints about rates.

- *Poor incentives for data quality.* Current law gives the Service opportunities to seek advantage in litigious rate cases through its control over what data are collected and how those data are analyzed and reported. PRC cannot compel the Service to collect data, update data, or subpoena information. The 1999 Data Quality Study, which you requested, Mr. Chairman, found that key postal cost data had not been updated for many years and were used regardless of their obsolescence.[12] Although the Service has worked to address these and

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

other deficiencies identified by the study, it is fair to question why these problems could linger for so long.

- *Disincentives for maximizing cost allocation.* Under current law, all classes of mail and types of service must cover their attributable costs, while institutional costs are allocated based on judgment informed by broad statutory criteria.[13] In effect, the Service loses pricing flexibility as costs are allocated to specific postal products and services, creating a structural disincentive to allocate costs. The presidential commission's conclusion that more postal costs can and should be allocated raises the issue of whether more regulatory authority is needed to ensure that all costs that can be rationally attributed are properly allocated.

- *Need for Periodic Reporting.* As the presidential commission noted, independent regulatory oversight should ensure that the outcome cannot be unduly influenced through the selective provision of information to the regulator. To this end, a key issue is whether the law should mandate the Service to submit periodic reports in accordance with form, content, and timing requirements determined by a regulatory body. This could involve changing the statute to clarify that the regulator could compel the collection and provision of necessary data, including rate-setting and performance information, that would be analyzed according to cost allocation methods determined by the regulator.

Worksharing discounts

A particularly controversial area includes consideration of worksharing discounts, which are applicable to about three-quarters of the Service's mail volume. Worksharing discounts did not exist when the Postal Reorganization Act of 1970 was enacted. 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.[14] Over time, the PRC developed a guideline for recommending worksharing discounts so that the estimated reduction

[13]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 institutional costs. This requirement has long been interpreted to apply to subclasses of mail.

[14]PRC is required to consider nine factors in making recommended decisions on postal rates, including such factors as fairness and equity and coverage of attributable costs. See 39 U.S.C. § 3622(b).

in Service revenues would be no more than equal to the estimated reduction in related Service costs. 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 versus a set of key principles or criteria for worksharing discounts should be established in law. Other issues and questions that have been raised in the rate-setting area 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?
- 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 a regulatory body be authorized to order the discontinuance of postal products and services that consistently fail to cover their costs?
- Could a complaint process, as a key mechanism to seek redress for rates established with no prior review, create an incentive for numerous complaints that could become a de facto review of virtually all rates? Even if a regulatory body could order changes in rates after the fact, would it be reluctant to do so, given the potential financial impact and disruption for the Service and the mailing industry?
- How much time is needed for meaningful after-the-fact review of changes in postage rates and review of complaints? What due process rules should be established for stakeholder participation in rate complaints and other rate-setting matters?
- 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 Service to collect data, as some have suggested?

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

- What statutory criteria should govern the adoption and review of negotiated service agreements (NSA)? Could NSAs create competitive harm, and, if so, what measures should be taken to mitigate this risk (e.g., prior review and other limitations)?

- Would a transition period be needed to successfully implement a different rate-setting system and address major unresolved cost allocation issues, as well as for the Service to improve its cost allocation methods and underlying information systems that provide costing data?

Price-cap regulation

As the above discussion demonstrates, the need for changing the postal rate-setting structure is clear. However, many questions remain about what changes should be made 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.[15] By its very nature, any 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 weighed against the benefits and risks of the status quo. If the Service is to be limited to its core mission, the flexibility provided by a price-cap system could become a key tool to successfully managing the transition to a leaner, more efficient postal system. A price-cap system also could enable the Service to implement a strategy of smaller, more frequent changes in postal rates, as opposed to a strategy of more infrequent, yet significant increases. We recognize that these proposals have been reviewed in numerous hearings, surfacing many issues and creating a valuable record to build on. Key questions to consider include the following:

[15] A price-cap system could limit rate increases for certain postal products and services according to a specified index, such as the Consumer Price Index.

- Would a price-cap system provide the intended incentives for the Service to maximize its financial performance, since it 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 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 the law require that rates for each class of mail or type of service cover the direct and indirect postal costs attributable to them? 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 wages and benefits for postal employees? 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 Service redesign the rate and classification system, as it did through the 1995 reclassification case, if it were subject to a price cap? How could more limited classification changes be adopted?

- Would adopting a price-cap system be too risky, given problems that have surfaced in some price-cap models adopted by other regulated industries? How could flexibility be built into the system to minimize risk and handle "the law of unintended consequences?"

- Should Congress specify provisions of a price-cap system? If so, what 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?
- What other regulatory models should be considered in the rate-setting area?

Constraints to Flexibility of the Service's Operations and Infrastructure

The Service's uncertain future regarding its mail volume and revenue growth makes it imperative for the Service to become a more cost-effective and efficient organization. To facilitate this, the Service's governing body and management must have the authority and flexibility to reduce costs and modify its business operations. There are a number of inefficiencies in the Service's current infrastructure, which has evolved piecemeal over decades and may not adequately reflect current and future needs. This infrastructure includes approximately 38,000 post offices, stations, and branches; 500 mail processing and distribution facilities; and other facilities. On the retail side, many post office transactions, like selling stamps, can be conducted more efficiently through other retail alternatives. On the processing and distribution side, efficiency varies across facilities, in part because the Service does not have standardized operations.

Although the Service recognizes the need to rationalize its infrastructure, several current legal constraints hinder its flexibility. A key question for Congress to consider is whether current legal restrictions on closing post offices should be retained, modified, or repealed. Under current law, the Service is not allowed to close post offices for economic reasons alone.[16] In making a determination on whether to close or consolidate a post office, the Service is required to consider the effect on the community, postal employees at that office, and the resulting economic savings, among other things.[17] All post office closings are also subject to a statutory

[16] 39 U.S.C. § 101(b).

[17] 39 U.S.C. § 404(b)(2).

process that governs notification and appeals, which can delay closings for an extended period.[18] In addition, annual appropriations bills have long specified that no appropriated funds shall be used to consolidate or close small rural and other small post offices.

Regulations further specify processes that the Service must follow for closing, consolidating, and relocating post offices. The Service can also suspend post office operations in an emergency without following the normal procedures but must notify affected customers individually and establish alternative services as quickly as possible. While there are no statutory regulations against closing mail processing and distribution facilities, these facilities are often co-located with post offices that are subject to statutory constraints. In addition, the Service often encounters political resistance when it determines to close, consolidate, or relocate postal facilities. Government officials are understandably concerned about decisions that affect customers, postal employees, as well as communities and constituents. In any event, it will be important for the Service to communicate with and consider the concerns of those affected by facility closings or other changes.

Greater flexibility for the Service to reshape its infrastructure must be accompanied by enhanced transparency and accountability mechanisms. Because rationalizing its infrastructure and workforce is crucial to the Service's future financial viability and has potentially broad impacts, we recommended that the Service prepare a publicly available plan that lays out its vision and strategies in this area.[19] This plan should include the key principles or criteria that will guide the Service's decisions, the processes that will be used to make its decisions, and the players that will be involved. We have also recommended that repeal of the escrow requirement be contingent on Congress's receipt of a satisfactory plan from the Service describing how it intends to rationalize its infrastructure and workforce.[20] Both the House and Senate oversight committees have sent letters to the Postmaster General requesting the Service to provide Congress with a plan for rationalizing the Service's infrastructure and workforce. Service officials told us that they are in the process of

[18]39 U.S.C. § 404(b)(3)(4)(5).

[19]GAO-04-108T.

[20]GAO-04-238.

developing the requested plan and intend to provide it to Congress by February 2.

Human Capital Issues

The Postal Service's human capital is critical to providing vital postal services to the American people and achieving a successful postal transformation. The Service employed almost 830,000 people at the end of fiscal year 2003, whose pay and benefits accounted for more than three-quarters of the Service's expenses. The Service reported that its operating expenses fell by about $1.3 billion in fiscal year 2003 due primarily to pension reform and work hour reductions. Another area where the Service continues to make encouraging progress is in the declining number of total grievances, which as of the end of fiscal year 2003 had fallen to 93,483, less than half the number at the end of fiscal year 1998. Further progress on controlling human capital costs will be critical to sustain both affordable and universal postal service. The Service's hourly compensation costs, including wages and benefits, are rising faster than inflation, and key issues remain unresolved regarding the Service's pension and retiree health benefits obligations. We believe that the time is right to consider what statutory structure would be appropriate to address these issues, facilitate best practices, and improve labor-management relations and overall working conditions. In this section of my statement, I will focus on (1) funding of pension and retiree health benefits obligations; (2) workers' compensation provisions; and (3) criteria for pay comparability.

Postal Pension and Retiree Health Benefits Issues

The Service's substantial obligations for its retirement-related benefits need to be addressed, especially in connection with its retiree health benefits. A key issue is how to assign responsibility and structure a mechanism for covering the costs of providing retirement-related benefits. Another issue is how changes in funding these obligations could affect postal ratepayers, taxpayers, and the federal budget.

The Postal Civil Service Retirement System Funding Reform Act of 2003 (P.L. 108-18), enacted in April 2003, 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. At the same time, the act shifted responsibility for funding pension benefits attributable to military service from taxpayers to postal ratepayers. The act 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 pension costs, the act required the Service, the Office of Personnel Management (OPM), and the Treasury Department to each submit proposals to the President, Congress, and the GAO by September 30, 2003. The act also required the Service to submit a proposal to the same recipients on how it planned to use the future "savings." We, in turn, provided our analysis of these proposals on November 26, 2003.[21]

Regarding the military service issue, the Service believes that the Treasury should bear responsibility for pension costs related to military service, while Treasury and OPM believe that this responsibility should remain with the Service. We do not take a position on whether the Service or the Treasury should bear responsibility for the military service costs, because we believe that this is a policy decision that should be made by Congress. Instead, we have identified and assessed the agencies' respective positions and provided additional information to assist Congress in making its decision. In this regard, two key issues were raised by the agencies, with differing views provided—(1) the relationship of military service to employing agencies' operations and (2) consistency among agencies, especially self-supporting ones. Regarding the first issue, the Service believes that there is no relationship between military service and postal operations and therefore the Service should not bear the pension costs related to military service. Treasury's view is that the employing agencies should bear this cost, because receiving credit for past military service is a civilian retirement benefit. Absent a conscious, voluntary, and contractual decision to the contrary, typical cost attribution methods would allocate service to the agency that benefited from the military service (Department of Defense). Under such a method, the taxpayers would bear the cost of pensions related to military service.

Regarding consistency, we reported that the Service is required to fund the dynamic normal cost of CSRS benefits, whereas some self-supporting agencies pay only a portion of this cost. Thus, we stated in our Matters for Congressional Consideration that Congress should consider treating all self-supporting entities consistently by requiring dynamic funding of the full cost of pension benefit costs not paid by employee contributions and deposits exclusive of military service costs. We also recommended that Congress should consider requiring consistency across self-supporting

[21]U.S. General Accounting Office, *Postal Pension Funding Reform: Review of Military Service Funding Proposals*, GAO-04-281 (Washington, D.C.: Nov. 26, 2003); and *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).

agencies in assigning responsibility for pension costs related to military service.

Should Congress decide that the Service should retain responsibility for funding military service pension benefits, the appropriate method for allocating the cost of these benefits would need to be decided. In this regard, we recommended in our report that an additional option should be explored for allocating these costs. Specifically, one that makes the Service responsible only for military service that became creditable after postal reorganization took effect on July 1, 1971.[22]

The second issue that Congress must consider is the Postal Service's report on use of the pension "savings." The Service submitted two proposals, both of which would affect postal rates to varying degrees. The first proposal recommends that the Service be relieved of the burden of funding pension benefits attributable to military service, and that the Service, in turn, would begin to prefund its retiree health benefits obligation for current and former employees, which has been estimated in fiscal year 2003 at between $47 billion and $57 billion. The second proposal is based on the premise that the 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 obligation only for employees hired after fiscal year 2002 and use the remaining "savings" to repay debt and to fund productivity and cost-saving capital investments. In our report, we noted that if either of these proposals were accepted, Congress would need to address implementation issues related to prefunding the retiree health benefits obligation, including who determines the amount of the obligation, what demographic and economic assumptions should be reflected in the obligation amount, and what funding and investment approach should be used.

We assessed these proposals according to their fairness and affordability and how they addressed the Service's transformation efforts, including its cost saving and productivity improvement initiatives. We found that the first proposal strikes a more equitable balance of allocating costs between current and future ratepayers because benefits being earned by today's employees would be built into the current postal rate base. Under the second proposal, a substantial portion of the retiree health benefits

[22]Military service that became creditable after postal reorganization would be for employees who did not have at least 5 years of civilian service prior to July 1, 1971.

obligation would remain unfunded, thereby placing the burden of the retiree health benefits being earned today on future ratepayers. Both of the proposals attempted to balance short-term rate mitigation with some level of prefunding of the Service's retirement health benefits obligation. In its first proposal, the Service estimated that an additional rate increase of 2 percent over the rate of inflation would be required in fiscal year 2006. The Service's second proposal would require only an additional increase of 0.3 percent over the rate of inflation since it would be funding a smaller portion of the retiree health benefits obligation. To mitigate the impact of any marginally higher rates needed to prefund retiree health benefits, we believe that the Service must transform itself into a more efficient and effective organization through continued modernization efforts.

Another matter we considered in evaluating the Service's proposals was the impact of the escrow requirement embodied in P.L. 108-18, which we determined could lead to unnecessary rate increases. However, we reported that Congress would need to have sufficient information to determine that the Service is making progress in achieving its transformation goals, including its initiatives to rationalize its infrastructure and workforce. Therefore, we recommended that Congress should repeal the escrow requirement upon receipt from the Service of an acceptable plan for rationalizing its infrastructure and workforce. Both the House and Senate oversight committees subsequently requested that the Service provide a plan on how it intends to rationalize its infrastructure and workforce, and the Service agreed to provide such a plan.

Workers' Compensation Issues

Another benefit area where postal costs have been difficult to control involves the Service's workers' compensation benefits under the Federal Employees' Compensation Act (FECA). The Service reported nearly $1.5 billion in workers' compensation expense in fiscal year 2003, only $50 million less than the record set in the previous fiscal year, while its unfunded liability for workers' compensation rose $526 million to a record $7.2 billion at the end of the fiscal year. We have reported on FECA issues, including how these benefits compare with those of other federal and state workers' compensation laws and possible changes to FECA benefits for beneficiaries at or beyond retirement age.[23] We reported that to help address FECA-related cost issues, Congress could consider converting

[23]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); and *Federal Employees' Compensation Act: Issues Associated with Changing Benefits for Older Beneficiaries*, GAO/GGD-96-138BR (Washington, D.C.: Aug. 14, 1996).

from the current FECA benefit structure to a FECA annuity. The presidential commission concluded that the Service should be provided relief from FECA provisions creating costly unintended consequences and that its workers' compensation program should be made more comparable to programs in the private sector. For example, the commission noted that unlike most private sector plans, FECA imposes no waiting period before benefits begin. The commission also pointed out that there is no maximum dollar cap on FECA payments, so that employees eligible for retirement often opt to stay on the FECA rolls rather than retiring. The current approach is costly and provides certain perverse incentives. As a result, we believe that placing workers' compensation benefits on a par with those in the private sector merits careful consideration.

Pay Comparability Issues

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 financially viable organization that can maintain affordable postal rates. One of the limitations in the existing collective bargaining process is that the interests of postal ratepayers do not appear to have been sufficiently considered. One option recommended by the presidential commission was to amend the law to mandate that a regulatory body clarify the term "comparability." In our view, Congress could revisit the statutory comparability standard so that it would more fully reflect the ratepayers' interests and the Service's overall financial condition and outlook. Comparability could be specified to include 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.

Some key questions related to the human capital area include the following:

- Should postal ratepayers or taxpayers pay for postal pension benefits attributable to military service of postal workers? Should this issue be resolved in a consistent manner for the Postal Service and other federal agencies that are also self-supporting?

- Should postal retiree health benefits be prefunded rather than paid on a pay-as-you go basis, and if so, to what extent? Should this issue be resolved in statute or delegated to an administrative or regulatory process?

- Should workers' compensation benefits for Service employees be greater than those generally available to private sector employees? What other opportunities exist to provide incentives to minimize workers' compensation costs?
- Should 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, what mechanisms should be required for independent reporting and oversight?
- Should the statutory pay cap on postal executives be lifted, and if so, how would executive pay be linked to performance? Should additional disclosure and/or independent reviews be mandated in this area?

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

Contact and Acknowledgments

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Mr. MCHUGH. Gentlemen, I am not going to take a lot of time asking questions, at least at the outset. I want to defer to my colleagues who were gracious enough to be here. I would just say that Chairman Fineman mentioned the train a long time coming. I am always reminded now, after 8 years of being at this, the story of the man who lived his entire life as a hypochondriac, and went to the doctor every week convinced that he had a life-threatening illness, and of course every week he was found not to. And then he finally died at the age of 109 and had on his tombstone: "See, I told you I was sick."

We have been saying that there is a crisis looming for about 8 years now, as you noted, David, but I think it is real. And in spite of the lack of material evidence of that, it has far more to do with the amazing job that Jack Potter and the 800-some thousand employees of the Postal Service have done in kind of patching up the holes that many of us on this side of the hearing room at least have chosen to ignore. And I don't think we can get away with it for too much longer.

I would just ask you good folks one question. There is a menu of things out here in the Treasury Department, and the President's Commission listed them as principles, but within each of those principles are some points. I don't know if it is within the political ability of the Congress to do everything we need to do in one fell swoop, but we are certainly going to try to do as much as we can, but there are certain political dynamics that can't be ignored. If you gentlemen could pick two or three items that you think are sine qua nons, absolute musts, without this, nothing, as opposed to reform, what would those two or three items be? And I am going to start with the Postmaster General, if he could tick them off, because he has the closest hand on the pulse, I think.

Mr. POTTER. Mr. Chairman, there are two things or three things that I think need to be done. First, the Civil Service retirement legislation needs to be brought to completion, and we were anxious to work with the committee to do that. In addition to that, I believe that we need to give management and the Board the tools when it comes to pricing flexibility. We need to be able to operate as a business. We need to be able to—along the lines of what David Walker just said, the Comptroller General just said—we need to be able to adjust our rates. And we would like to be able to do that on an annual basis so there is no sticker shock, so that we are able to take into account what happens over the course of the year. And, last but not least, we need to have the ability to manage our infrastructure and to make what are going to be some tough decisions to modernize the Postal Service and make it more efficient.

Those are the three things I believe are most important.

Mr. MCHUGH. If I could come back down to General Walker.

Mr. WALKER. Large agreement. I believe you need to deal with the most immediate issues, which are military service and the escrow. I believe that it is important to provide additional flexibility to rationalize infrastructure and work force issues, and also to look at how rates are set. I think those are the three key issues that are of critical importance.

Mr. MCHUGH. David? You have only got a year left or so; you can disagree with Jack.

Mr. FINEMAN. Right. No, I am not disagreeing with anybody. I think that the bottom line here is that we have to be able to run a business that allows us to manage to the bottom line. As of now what we do is we say, "OK, it is just a break-even proposition." I think that we have to add incentives that allow management to manage to the bottom line. Let them run it like a business, let them make a profit, let that profit be distributed to executives. Run it like a business. And I think that if you would manage to the bottom line, you might be able to bring about more productivity in a better-run service.

And the ratemaking process, as somebody who sat on the Board for 8 years, I listened to David's testimony at the end when he talked about rate increases. I agree with you, David. The problem is, under the present process, what we are confronted with consistently is a process that makes no sense; so, therefore, we are put into a box. We are put into this terrible box where we say, "If we raise rates, we will have a declining base of mail." And you know what? We can't raise rates for another few years because we don't have any flexibility. Under those circumstances, it becomes a business that is just unmanageable.

Mr. MCHUGH. George, you might want to say something about your need for flexibility on the regulatory side.

Mr. OMAS. Well, I think there can be some flexibility. In my opening statement, I mentioned that I totally agree with flexibility. However, the Postal Service should realize that it is a government entity. They are an operator, and as an operator they should have a certain amount of oversight, and that oversight was recommended. It would be up to Congress to determine whether it is in the form of a regulatory board or whether Congress does that.

But I think that serious thought should be given to the monopoly and to the universal service. Right now, the Postal Service defines both of those things, and the President's Commission recommended that go under the regulatory board. It views the Postal Service as the operator and the regulator as the government entity to oversee those things and to make that decision. And I think it would behoove Congress in their legislation to give guidance to both the Postal Service and to the regulatory board or to whomever would regulate those entities.

And just in one other comment, we get beaten up about the process, the process, the process, the process. Mr. Chairman, we follow the guides of the law, of Title 39, and as a result we try to do the best job we can. Since I have become chairman, I have tried to open up and work and to experiment within the guides of the law to give the Postal Service more flexibility in the form of negotiated service agreement classifications, and we have settled over 14 cases since my tenure. And I think that the process is broken to some degree, and it needs to be looked at, but right now we do work within the guides of the law.

Mr. MCHUGH. Well, let me say, I have had a lot of conversation with David Fineman, with Jack Potter, a lot of people in the postal administrative level, and it has never been an issue of the PRC not doing its job. It is the process, it is the law. And that is one of the things we are looking to streamline. And by the way, I certainly

don't want to see Congress as a direct regulator in the Postal Service. We got rid of that in 1970, and good riddance.

Mr. Secretary, we really do have to go vote. I think it would be unfair of me to ask you to pick amongst your principles. If you want to do that when we get back, you know, load up the gun and put it to your head and—I will be happy to. But as I said, in fairness, I think the Commission and the administration did a good job, and we will stick by that. So having said that, I would ask your patience, and we will be back as soon as we get finished with this vote. We will stand in adjournment.

[Recess.]

Mrs. BLACKBURN [presiding]. We will be called back into order and reconvene. I will take the Chair's spot until our chairman is able to return, and we thank you all for your patience. Of course, seeing that you are productive and viable and solvent is important to each and every one of us, and we appreciate your patience because we all do have some questions that we would like to ask and some things that we would like to get on the record. So if I may—and it looks like I am the only Member to finish my votes. I guess that just goes to show, if you want it done right, ask a woman; get it done right the first time.

Secretary Roseboro, I think I will begin with the questions that I had wanted to ask you. If the Postal Service is to operate as a self-sustaining commercial enterprise, which we have heard mentioned repeatedly not only in the written testimony but the testimony delivered today, it needs—Mr. Fineman mentioned several times it needs to run like a business, we need to have it run like a business. Then—and everyone has mentioned flexibility and the importance of flexibility. What boundaries and flexibilities specifically—and I am looking for specifics, not just generalities—but specifically should be given to the Postal Service to deal with the problems that you have, such as debt and deficits? And the reason I would like some specifics on this is because both in the written and the delivered testimony, there has been mention of the services delivered charging at a rate enough to cover the cost so that you would be self-sustaining. So if you will talk a little bit about the boundaries and the flexibilities to deal with those issues.

Mr. ROSEBORO. Yes, thank you.

We feel, again, as that principle outlined—and this ties into Chairman McHugh's question just before he left—what principle would we greatly endorse if we just had to choose one. Ensuring the self-financing principle of the Postal Service is critically important. And that would, in terms of specifics, actually dovetail well into what the previous panel members mentioned in terms of those specifics, which I would say the administration is in agreement with except for the disposition of the Civil Service Retirement System military funding issue.

More specifically, again, with regard to the flexibility to respond to the macroeconomic environment and have some flexibility, or greater flexibility, to respond in terms of rates, as Chairman Fineman articulated earlier, the difficulty in the long-term process of being able to foster rate increases as needed in response to events is a burden, a liability on the Postal Service. To have flexibility as well on the cost side in terms of managing technology im-

plementations, managing the development of the workforce as is directed toward the Postal Service's business needs we think would be key criteria to meeting this principle of self-financing with regard to that. As well the bottom-line objective or mandate of the Postal Service of having to break even, also we would be supportive of a bit more flexibility in that regard, given the variable nature of year-to-year, of ups and downs in the business cycle or other surprising challenges that are met. For example, if the Postal Service could retain earnings in the eventuality of or to plan for negative swings would be a specific prescription that—or flexibility that we think should be considered.

Mrs. BLACKBURN. Now, when you talk about having some of the flexibility, and specifically looking at technology implementation, have you developed a plan of what you would do? Do you have a long-range plan? Do you have a time line on implementation? Or at this point are you just in broad-brush thinking, putting it down, putting a plan together? Where are you on that?

Mr. ROSEBORO. We feel it is just appropriate at this time for it to be a guiding principle for postal——

Mrs. BLACKBURN. But you have no specifics.

Mr. ROSEBORO. No, we don't think it would be appropriate for us to have specific prescriptions in that area or many of the other areas, specifically because that would be more micromanaging business, which the Postal Service is in a better position to implement as well as address.

Mrs. BLACKBURN. OK. And if you continue to operate at a loss for the next several years, what would be the appropriate actions to remedy that problem?

Mr. ROSEBORO. We don't think there is any one action. Again, we would encourage flexibility on the revenue as well as cost side, a thorough analysis accounting in terms of product lines, activities of the Postal Service to make sure that all of those, the areas that it is involved in, are cost-effective and will serve its customers well.

Mrs. BLACKBURN. So there are no specifics for how you would remedy that situation?

Mr. ROSEBORO. No. We would rely on the Postal Service's management and its Board of Directors to address the specific drivers of those factors, that they analyzed them and managed them over the year, and would look to work with them as we do in terms of any borrowing needs they have through the Treasury directly, and working with Congress to address the other issues that they would need help with to remedy the specific problems that would arise driving the loss scenario which you described.

Mrs. BLACKBURN. Thank you, sir.

Chairman Fineman, I want to talk for just a moment about mail. You mentioned that—let's see. Your volume, your first class volume, was reduced by 3 billion pieces in 2003, and that first class mail is less than 50 percent of your total volume; and that overall your drop in first class mail last year was 3.2 percent, which resulted in a $1.2 million loss. Am I correct?

Mr. FINEMAN. $3.2 million loss in that category mail. Is that what you are saying?

Mrs. BLACKBURN. In that category. OK. And standard mail has increased by 3.6 percent.

Mr. FINEMAN. That's correct.

Mrs. BLACKBURN. OK. What I would like to know is if you—is this a recent or a long-term trend? And then as you look at different revenue streams becoming more profitable, what are you all doing to maximize that, and where is your emphasis on growing those streams?

Mr. FINEMAN. I am going to attempt an answer to your question, and I am going to ask the Postmaster General to comment on my answer afterwards, if that is OK with you.

Mrs. BLACKBURN. Sure.

Mr. FINEMAN. First of all, let me try to start with the recent and long-term effects. We began to see some of what we call diversion of first class mail sometime in early—around 2000 you started to envision that it was happening. We knew that it was happening within society. But to a large degree the model that we have was based upon there being continual increases in first class mail. So what was happening initially was that the increases——

Mrs. BLACKBURN. Excuse me just a moment. When was that model constructed?

Mr. FINEMAN. 1970.

Mrs. BLACKBURN. OK.

Mr. FINEMAN. So what you began to see was that the increases were not the same as the increases had been previously. You no longer were having that same increase in first class mail. Remember, at the same time that we are getting decreases in mail, the fact that really comes home to you is that we are increasing the number of addresses that we are going to have to deliver mail to. Leave aside what the burden is. One would think naturally that what would happen is that if you increase the number of addresses about 1.7 million a year, because you have new homes that are being built—I kind of use the analogy, you know, somebody who played by the rules, sent all their kids to college, and they had three children. You know, one of them moved to Las Vegas, one of them moved to Arizona, the other moved around the corner, and Mom and Dad still stayed there.

Mrs. BLACKBURN. They are the lucky ones. Some of them come back home.

Mr. FINEMAN. Right. But we have three new houses to deliver to, and we still deliver to Mom and Dad. So we increase the number of houses. You would think, well, then you are going to increase the volume of mail. But it didn't happen that way. And we began to see clearly this decrease in 2002, you know, of 1 billion pieces and 3 billion in 2003. And now the model is broken, and it is hard—if you read the President's Commission and our internal studies, it is very hard to predict. You know, if we went from 1 billion to 3 billion, does that mean that in 2006 we are going to be at 9 billion? I am not quite sure that that is the number. And why is it so important?

You know, when we construct the model—and the Postmaster General can comment upon this. But from our financial situation, first class mail is the largest contributor to overhead. So when you talked about we are increasing, the increase in standard mail, sure, the postperson who comes to deliver mail to your home is maybe delivering some more standard mail than they might have deliv-

ered previously, but they are delivering less first class mail, and there is less of a contribution for that.

It is less—if we just talk about it in terms we would understand, we don't make as much profit on it, we don't do as well. Where are the opportunities? I mean—and that was the next question that you asked, I think. From our point of view as a board, we have asked management and management has made a big effort this year that what we want them to do is to increase the opportunities for revenue. We want to look at those opportunities within what is our business; not divert to e-commerce, not diversion to anything else, but within our business. We want to have postal people out on the street selling our product to small businesses. We want to increase the amount of marketing that we are doing within the advertising community and to other communities, and we have made a big effort this year, and we have asked the Postmaster General to make this one of his priorities, which he has done.

And I'd ask the Postmaster General if he had any comment about my answer to that question.

Mr. POTTER. Let me just add that we are facing a structural issue here. Historically, as homes grew and businesses grew, so too did mail. And right now, our possible deliveries, the amount of deliveries we make, rises about 1.2, 1.3 percent a year. That's 1.8 billion deliveries, the equivalent of the size of the cities of Chicago and Baltimore. So we're growing at that level every year. Mail volume has not kept pace with that. If it were, we'd see a 1.2 percent growth in first class mail and in other classes of mail.

Now the reason why first class mail has declined, there are a number of them. Right now we're not sure how much the economic conditions have caused the reduction of first class mail. We know that jobs are down and we think that there's a correlation between first class mail and people working. We also know that there's a structural change where mail is moving to the Internet. In addition to that, our standard product has gotten much better and first class mail is about 18 percent advertising. And people have bought down from first class mail to standard mail as a result of the better performance that we're giving it. So in a sense the service that we're giving has hurt us a little. But that in a nutshell is the problem that we have.

Now, what we're doing to try and offset that are a number of things. First, we're very much focused on productivity, because if we don't improve productivity our only recourse will be to raise rates, assuming that volume doesn't grow. So our initial thrust has been to go after productivity to try and offset this increased infrastructure that we have to deliver to and we're delivering less revenue over a broader infrastructure—a broader delivery base. In addition to that, as the chairman said, we're going after growth this year. We're working with all of our customers to determine whether or not the decline that we've seen is a result of truly a structural issue that we'll never see the mail come back or whether there were other reasons why people aren't mailing. And I think over the course of this year we're going to learn a lot. 2001 and 2002, 2003 were unique years. I think we're starting to see the economy rebound. We're hopeful that mail will rebound with it and we are going to work hard to help mail rebound with the economy.

Mrs. BLACKBURN. OK. Now, if the Postal Service were limited only to first class and standard mail, then what effect would that have on your revenue and your infrastructure?

Mr. POTTER. First class and standard are about 90 percent of our revenue and obviously, therefore, the infrastructure wouldn't change that much because we'd still be going to every door every day. Some of our plant operations might be modified. But the fact of the matter is the bulk of the infrastructure would stay just as it is.

Mrs. BLACKBURN. So those two combined are 90 percent. I thought first class was 93 percent. So I guess that was an incorrect figure.

Mr. POTTER. First class mail is about half of our total volume and it's about 65 percent of our revenue.

Mrs. BLACKBURN. OK. All right. Chairman Fineman, again, let's talk about labor costs. And your labor costs are 80 percent of your operating expenses, is that correct?

Mr. FINEMAN. I think just about that. The Postmaster General whispered into my ear "78 percent." I know we've always been in and around 80 percent for the last few years. It's been decreased on a percentage basis, but about 80 percent.

Mrs. BLACKBURN. And how does that compare to similar industries in the private sector?

Mr. FINEMAN. It's difficult to answer that question because you've got to remember that we put it within a sector. You know, within—what sector would you compare us to? Would you compare us to some sort of service business or to other mailers who were doing other kinds of business? Similar to our business, that is, you know, UPS's mainstay is packages or FedEx's mainstay is——

Mrs. BLACKBURN. You choose the examples. I'd just like to know.

Mr. FINEMAN. Right. I'd suspect our costs are higher on a basis percentage. But maybe the Postmaster General can answer that question with specifics.

Mr. POTTER. I don't think there's a comparable institution out there that you can compare us to. We have a mandate to go to every door 6 days a week. No one that I'm aware of has such a labor-intensive requirement.

Mrs. BLACKBURN. OK. That is fair. I still think that there are some comparisons that could be drawn with other services that are within your industry sector as you look at what your labor costs are and consider what those are and what it means to your bottom line.

Let's see. General Potter, let me ask you, if I may, just one thing. On the integrated technology, how have you integrated technology into your operations as far as your productivity? You mentioned that was one of your focuses, so where are you with that?

Mr. POTTER. Where are we? Today 95 percent of all letter mail that comes into the Postal Service to be sorted is sorted on automated equipment. Today about 80 to 85 percent of the mail that a carrier brings to a door is walk sequenced by a machine. It's not sorted by a carrier. In fact it's not touched by the carrier until they get on their route. We have the most modern and efficient postal service in the world. We've made capital investments in automated equipment throughout the years to modernize ourselves. We have

plans to continue along those lines that we're going to share with this committee in our response for more detail on our capital plan. We do have areas of opportunity and we're continuing to explore the notion of using capital to improve our productivity. We have never put a cap on expenditures when it comes to capital or automated equipment that has a return on investment. And we continue to make that our No. 1 priority when it comes to use of our capital resources.

Mrs. BLACKBURN. And what percentage of your annual budget are you using on technology and equipment?

Mr. POTTER. We spend anywhere from $1 billion to $1½ billion a year on automated equipment.

Mrs. BLACKBURN. OK.

Mr. POTTER. And as a matter of fact, when it comes to computer technology, IT technology, the Postal Service has and will replace its entire infrastructure of—from PCs to servers throughout the Nation—we will have, I believe if we don't already have, we will have a world class IT infrastructure. We do not minimize our investment when it comes to IT.

Mrs. BLACKBURN. So 85 percent of your operations have transitioned to bar code or optical reader sorting; is that correct? Is that what you said?

Mr. POTTER. That's letter walk sequence and when it comes to oversize letter mail, flat mail, it's above 90 as well.

Mrs. BLACKBURN. OK. Excellent. And Chairman Fineman, you mentioned the business model and the old model was constructed for you in 1970. Who is working with you on constructing a new business model? Are you outsourcing that? Have you brought a consultant in, or who is advising on that?

Mr. FINEMAN. The board and management has been working closely to try to come up with what would be a new business model, and I look at your counsel here, I would only say that we've worked closely with this committee for almost 8 years now to try to construct a model that'll make some sense for the future. We've commented upon various pieces of legislation and have from time to time over the years submitted our own legislation, so we look forward to working with this committee to get legislation that we think can correct what is a deficient model that was constructed in 1970.

Mrs. BLACKBURN. OK. Mr. Walker, I always enjoy my conversations with you. It's always great and I guess—may I continue questioning since no one else has shown up? And I did reserve my time. Y'all have to remember that. I didn't have an opening statement. If the Postal Service were subject to SEC reporting requirements, would they have sufficient financial transparency?

Mr. WALKER. No. They would need additional transparency in order to meet the SEC requirements. I will say that the Postal Service is making progress with regard to the transparency issue. They have done some things already. They've got some other plans in process right now. I would also say that one of the reasons that I didn't say that transparency was one of the areas that would necessarily require legislation is because people can do what they believe is the right thing without legislation and SEC registration. Specifically, the Board and management could decide that in sub-

stance they want to meet the SEC requirements and therefore wouldn't require legislation. So that's why it wasn't one of my top three priorities.

Mrs. BLACKBURN. What about FFMIA?

Mr. WALKER. I don't believe that they would be totally compliant with that. As you know, they are focusing on the private sector model, and private sector entities aren't subject to FFMIA, and therefore, there would be some gap there.

Mrs. BLACKBURN. OK. How would—or can you target anything that would—any specific that financial transparency would do to help with their efficiency and their operations?

Mr. WALKER. Well, clearly we believe that they need to go to—you know the SEC requires quarterly reporting, fairly extensive reporting with regard to not only financial results but also operating results and we think it's important that comparable to SEC information reporting should occur. I think another area that I have testified on from time to time, where some additional progress has been made but we think additional progress is necessary, is the Postal Service's significant retiree health obligations, which were estimated to be between $47 and $57 billion in current present value terms.

Mrs. BLACKBURN. And one last question. What would be your assessment of the management structure that is in place at the Postal Service?

Mr. WALKER. You mean how much management, the layers of management?

Mrs. BLACKBURN. Correct. The layers, right.

Mr. WALKER. We have not done a separate, independent assessment of the management structure. Let me just say this, Madam Chair: I believe that the Postal Service needs to be subject to the same thing that much of the Federal Government needs to be subject to, and that is what I'm going to refer to as a baseline review. The Postal Service is doing many good things and they've made a lot of progress in the last couple of years under the leadership of Chairman Fineman and Postmaster General Potter. But they face a major challenge; their business model is based upon the 1970's. The world is fundamentally different. On my belt I have two of their competitors. I have little doubt in my mind that there are permanent structural changes that have occurred. Reasonable people can differ as to what the magnitude is and whether some things are just timing differences with regard to employment levels, etc., but I think they're going to need to fundamentally reassess their infrastructure, their human capital policies and practices, their rate-setting, and what the scope of their business ought to be. I mean, getting back to the core business, if you will, capitalizing on their inherent assets—which is the first mile and the last mile—capitalizing on what they can do to also generate additional revenue or cost-sharing dealing with their significant infrastructure, I think there are real opportunities. But I think it's a fundamental review and reassessment, including the ratio of management to individual contributors, how many layers, how many levels. I think it all has to be reviewed and reconsidered.

Mrs. BLACKBURN. Thank you, sir. I see that our chairman has returned and I also know that Mr. Roseboro needs to be excused, that 5 is the time that you need to depart.

Mr. ROSEBORO. Yes, unfortunately. I have a prior commitment with some of your other colleagues on another issue, but any questions that yourself or any other committee members have I'll be glad to answer in writing back to the committee.

Chairman TOM DAVIS. I had one burning question, Mr. Roseboro, for you that I just can't resist. Are you related to John Roseboro?

Mr. ROSEBORO. A distant cousin.

Chairman TOM DAVIS. He was one of my favorites, so I couldn't help but ask that question. The others I'll write.

Mr. ROSEBORO. Thank you.

Mrs. BLACKBURN. Mr. Davis, would you like to be recognized for questions?

Chairman TOM DAVIS. Thank you, Madam Chairwoman. I guess I've really got a whole bunch of them, but Mr. Postmaster General, in your testimony on page 6, you expressed concern over the Presidential Commission's recommendations to limit the Postal Service to activities directly related to its core mission. You state that the Postal Service needs to maintain the flexibility to pursue appropriate revenue streams in areas related to core businesses. Yet Chairman Fineman mentioned some difficulties the Postal Service has had such as in e-commerce. Could you elaborate on the type of flexibilities you have in mind when you——

Mr. POTTER. Yes, Congressman. What I've observed around the world is that other Postal Services have the same challenges that the U.S. Postal Service has. And what they've done is, they've looked at their infrastructure to determine whether or not there were opportunities to take advantage of the infrastructure that they are trying to maintain. So, as an example in the retail arena, in other posts around the world, they use that retail service to offer banking access to communities that may not have a bank. And so when I talk about other services, I'm talking about within the structure of the facilities that we have to maintain. I'm not talking about becoming an e-commerce company. But the fact of the matter is, we have a lot of trucks and other folks have gone beyond mail and are using those trucks and moving into the whole area of logistics and moving freight. And I don't think that going forward we'd want to preclude that the only thing that the Postal Service could do with its infrastructure would be to deliver, you know, a 1-ounce letter. And I think we should be open-minded about that going forward.

Chairman TOM DAVIS. I attended—and this might be for each one of you because it can be fairly brief—I attended a union meeting a few weeks ago, and I thought I was at—well, I don't know what I thought I was at because there was a tremendous amount of frustration displayed at that particular meeting in terms of fears that the individuals there were expressing about things that were already happening such as excessing. They were highly frustrated by that but also by the possibility that there may be serious closures, that there may be a serious reduction in personnel, that there may be conditions changed from what they were accustomed to, that our definition of universal service may be restructured and

changed. How would you respond to those fears that are being expressed, especially by individuals who work for the Postal Service?

Mr. POTTER. Well, Congressman, I hear those fears all the time. In fact, one of the reasons that we agreed to a contract well in advance of contracts expiring with a couple of our major unions was in response to concerns of some of our employees regarding layoffs. And I, as a result of those contracts—those contracts contain no layoff clauses—I wanted to assure every one of our craft employees that there are no plans to lay off those employees. However, the fact of the matter is, Congressman, that mail volume is declining and mailers are changing the way they present mail to the Postal Service. When I began my career in the Postal Service, every piece of mail that left Washington, DC, and was bound for another part of the country was handed to the Postal Service. Today there are rates that allow people in Washington, DC, to truck their mail across the country and deposit it for a discount. All those folks that used to move the mail from one end of the country to the other are no longer needed because of the fact that there's been a change, a behavioral change on the part of mailers. And again, it was in response to a discount, but they've changed their pattern of deposit of mail.

What we've done is we've looked through this network and we've determined that there are people who are not as productive as we'd like them to be, and we do need to move them to more productive jobs. The security is that they won't be laid off. They will have to move to where the work is. We can't have unproductive people. And we're trying to be as accommodating as we can and as considerate as we can about their individual needs, but we need to react to what's going on around us. As far as I'm concerned, if you look at the long-term viability of the Postal Service and the security of these folks' jobs, we need to react today and we need to react together, working together to ensure that we don't have a situation where rates could rise precipitously, as I said in my testimony, because we don't address those places where we're not as productive as we could be.

Now, the fact is, and I would share the concern of folks, we've dropped over 80,000 people in the last 5 years. Since 1999 we've dropped 80,000 career employees. We've done that in response to what's gone on with the mail. We've done it as a result of investments that we've made in technology and automated equipment. And as you can see, from everyone that's talking here today, it doesn't appear to be enough. So we need to continue to change. I think our employees understand that we need to change as society changes, as use of the mail changes, and again we're trying to work with people, keep them informed and we want to assure them and have assured them through the contracts that we do not plan to lay them off.

Chairman TOM DAVIS. Mr. Walker, do you have any ideas relative to how long it might take the normal rate of attrition that's being dealt with as well as the efficiencies that are being developed before we reach a point where there would in all likelihood have to be some serious postal changes?

Mr. WALKER. Well, I am not privy to all the detailed data the Postmaster General would have. I will say this from a conceptual

standpoint: change is inevitable. The fact of the matter is, if you look at the trends and challenges that face the Postal Service in the United States and what's occurred over the last 40 years and what's likely to occur in the future as we end up updating the business model, there are going to have to be changes in a variety of areas, including in the area of the work force.

Now what the Postmaster General has tried to do is to try to avoid layoffs, and the way he's done that is through the bargaining process. I would respectfully suggest, I personally am a strong believer in collective bargaining and to have the parties try to work these things out. The fact of the matter is that they do have shared interests to the extent that the parties can end up making sure that compensation is reasonable and competitive in the aggregate sense, to the extent that the parties can end up increasing flexibility for work rules and utilization of the work force. That can help to minimize, delay and hopefully avoid in some cases any layoffs that might ultimately have to occur down the road. But I think the bottom line is that normal attrition can help you get to where you need to be, but you don't necessarily have the amount of attrition at the time in the areas that you need in order to get the job done. And so that's why you have to do a much more, I think, sophisticated work force planning effort to try to understand where are we, where we think we're going to need to be, how we are going to get there, how much of it can come through normal attrition, how much can come through early outs or other types of mechanisms, and where might there be some other opportunities to redeploy the work force and still maintain employment opportunities at reasonable wages.

Mr. POTTER. If I could add, we have a great opportunity right now because today the Postal Service has over 120,000 employees who are eligible to retire. We have another 130,000 who will be eligible within the next 5 years. So there is an opportunity to make the kind of structural changes that we think might have to happen and do it through the collective bargaining process, do it in an employee-friendly way. Now that doesn't mean that we're not going to change people's schedules. We may ask them to, you know, drive down the road 5, 10 miles to be employed but they will be employed and we are working through that process with the unions and with individual employees to deal with issues that people are going to have with change.

Chairman TOM DAVIS. Well, thank you very much, Mr. Chairman, and I thank you gentlemen. I'm going to have to leave in order to catch a flight tonight. But I would say that I really appreciate the candor of your testimony. I'm reminded of something that Lyndon Johnson used to say and that is speak truth to the people. There are no gains without some pain. And so it looks as though there's going to be some pain. But we obviously want to make that pain as narrow as possible.

So I thank you very much and I thank you, Mr. Chairman.

Mr. MCHUGH [presiding]. I thank the distinguished gentleman, wish him a safe flight and, as always, greatly appreciate not just his participation but his leadership.

First of all, I want to apologize to everyone for my tardiness in coming back. I had a must-do conference call with Senator Clinton.

We had an unexpected plant closure in my district and it was just unavoidable. I would have rather been here, trust me, given the topic of that call. As such, I was not privy to a lot of the give-and-take and the Q-and-A, but having had the opportunity to talk to most of you in the past, I suspect I note the tenor.

I would just put in an editorial comment. Well, let me ask one question, because I hear some back-and-forth about parcel delivery, and that not being the core which is absolutely true of the Postal Service's revenue stream, etc. And we've got a lot of great private parcel carriers in this country. Two particularly come immediately to mind. I'm not providing them free advertising time, I'll just leave it at that. But as someone who lives in the rural part of the country I place a particular value on that option for the folks that I represent, because there are some higher cost alternatives, but the Postal Service is an important alternative to those. And did I understand, Mr. Potter, you to say that in the immediate future you do see parcel delivery as part of your mission? I mean, after all you have a parcel delivery agreement, do you not, with one of those companies as we speak?

Mr. POTTER. I think parcel delivery is a core product of the Postal Service. The questioning was along the lines of how much of your business is first class mail and standard mail and I answered those. And if the attempt was to try and minimize our commitment to parcels, certainly I wasn't trying to portray that in my response. There are many Americans who rely on access to parcel services to put a parcel into the system, using our 38,000 outlets. We deliver to communities without a surcharge that others would surcharge. I think we provide a vital service to America when we deliver parcels, and our intent is to make sure that we continue to do that well into the future.

Mr. MCHUGH. Yes, sir. Mr. Chairman.

Mr. FINEMAN. Congressman, can I just make one comment, which is, there's no reason—and one of the things that the board has looked upon favorably, former Governor McWhorter, who was Governor McWhorter, the former Governor of Tennessee, I remember him commenting upon this. He just left our board. There's great opportunity here. There's no reason why there has to be this friction. We deliver to the last mile, to every household, to all those rural areas that you represent. We are beginning to work with those that have been considered to be our competitors, beginning to work with them as they realize that we can do that in a fashion that they might not be able to. And therefore, it would cost the customer less money for them to deliver the packages to the Post Office some place in your congressional district and let our letter carrier deliver it the last mile rather than them having a truck that delivers one parcel to one little town in your area and another parcel to another little town. That costs a lot of money. Our people are on the street all the time. So we look forward to working with them. There's no reason we have to be antagonists.

Mr. MCHUGH. Well, I wish you well in that, and certainly in theory that's absolutely correct. I couldn't agree more. You know, in fairness, there are some competitive issues, equitability and competitiveness, that need to be addressed. I mean they have the right to make a dollar and to make a lot of dollars and they have and

they should continue in the future. But I just wanted—because I kind of caught the back end of that conversation—I just wanted to make sure that the record showed what I thought was the case. And I appreciate that clarification.

Anybody want to say anything? General Walker.

Mr. WALKER. Mr. Chairman, I think it is important that the Congress get as much done as quickly as possible. Earlier, there was a discussion about if you couldn't do the whole enchilada this year, whatever that is, then what are the most critical elements? I think my comments were very consistent with Postmaster General Potter's and the others' comments. But those are in fact essential, essential that those be addressed. It is desirable that more than that be addressed but those three elements I believe are essential.

And on the issue of transparency, I think much can and should be done without legislation there and hopefully that'll get the job done without legislation. That's something we can always go back and revisit if for some reason people don't voluntarily do what is arguably the reasonable and appropriate thing to do.

Mr. OMAS. I would like to concur with Mr. Walker that legislation is definitely needed. However, I would like to take this opportunity to commend Postmaster General Potter and Mr. Fineman for the cooperation that we have been able to pull together in the last year or so and I'd like to thank them. And I know the mailers and the stakeholders are appreciative. We have started programs whereby the Postal Service will brief us on new costing methods as well as the fact that the commissioners meet several times a year with the Board of Governors to discuss various issues. So we do need legislation, but we're trying to work within the parameters, which we will endeavor to do until there's legislation that changes that.

Mr. MCHUGH. Well, I appreciate that, George, Mr. Chairman, and it is important and there are a lot of opportunities to have everyone work more cooperatively together. And General Walker mentioned transparency and then the rate-setting process that, as you noted earlier, Mr. Omas, is a problem that you are dictated to in terms of the structure, the procedure, and we need to update that. I think—I'm a big believer that if we're going to provide this flexibility then I think everyone in this room knows I believe in very, very strongly, but an empowered regulator of some sort, an overseer outside the Congress is equally important and subpoena power and such and such. So you know I am sure that those are things that we are going to be looking at. But the main objective at the end of the day is to have a Postal Service that continues to be what it has been for over 2 centuries, and that is the lifeblood of communication in this country for the foreseeable future, and that's what we are going to do. And to that extent I want to thank all of you gentlemen. You've been terrific on this and leaders, and over 3 hours we'll get you a couple more gold stars.

So with that and our appreciation, we'll adjourn the hearing until we reconvene in the windy city of Chicago next week. So y'all come.

[Whereupon, at 5:20 p.m., the committee was adjourned.]

[The prepared statements of Chairman Tom Davis and Hon. Candice S. Miller follow:]

OPENING STATEMENT
CHAIRMAN TOM DAVIS
GOVERNMENT REFORM COMMITTEE
SPECIAL PANEL ON POSTAL REFORM & OVERSIGHT
"ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM"

28 JANUARY 2004

I would like to begin by thanking the Chairman of the Special Panel, John McHugh for conducting this series of hearings, and I would especially like to thank him for his leadership and vision on this important issue. Together with the Ranking Minority Member of the Committee, Henry Waxman, and the Ranking Minority Member of this Panel, Danny Davis, we intend to craft postal reform legislation that will allow the Postal Service to survive well into this century.

Let there be no mistake, the survival of the Postal Service is what is at stake here. As Mr. McHugh pointed out, and as the witnesses here will testify, the Postal Service badly needs comprehensive reforms in order to continue to provide the service upon which all Americans – including the 9 million Americans employed in the postal industry or postal dependant business – rely.

Mr. Chairman, the last time Congress passed comprehensive postal reform, many of the technologies we take for granted today – such as fax machines, email, and the World Wide Web – were the stuff of science fiction. But the threat of electronic diversion to the Postal Service's ability to provide uniform service at uniform rates is very real today. First Class Mail volumes have been in decline for several years, and the only way the Postal Service can legally respond to declining volumes and revenues right now is by raising rates even further. As rates go up, even more volume leaves the system, contributing to what David Walker, who will be testifying this afternoon, has called a "death spiral." If we do nothing, the Postal Service will be defunct before we know it.

I believe the time is ripe for Congress to prevent this from happening. For the first time since the Nixon Administration, the White House has called for comprehensive postal reform. Our colleagues in the Senate are as committed as we are to preventing the Postal Service from melting down. We also have the guidance of the President's Commission on the Postal Service, which did an extraordinary job in a very short amount of time. Last but not least, we can build on the nine years of hard work Chairman McHugh has devoted to this issue. I look forward to working with him and with our colleagues on the other side of the aisle as we confront this vital issue.

Congresswoman Candice S. Miller
Special Panel on Postal Reform and Oversight
Committee on Government Reform
Opening Remarks
Tuesday, January 27, 2004

Mr. Chairman, thank you for your leadership regarding reform of the United States Postal Service. As Members of Congress, we are presented with an opportunity to change the way the Postal Service does its business. Its current business model is not sufficient for the 21st century, and Congress has not tackled substantial reform since 1970. Now is the time to act and I appreciate you, Mr. Chairman, for holding this hearing.

I would also like to thank Chairman Davis of the full Committee for supporting the Special Panel on Postal Reform and Oversight. As Michigan's Secretary of State for eight years, I reformed a large government agency. Among its various jurisdictions, the Department of State in Michigan is responsible for the licensing of drivers and vehicle registration. Upon taking office in 1995, the Department of State in Michigan was an antiquated agency, without even a fax machine in any of its 180 branch offices. Within a few years, the Office became a national model for its use of technology and its improved efficiency and cost-effectiveness. The office I directed was able to expand services even as budgets shrunk.

Reform at the Federal level is much more extensive and difficult, but the challenges this Congress faces are strikingly similar to the challenges we faced in our State government. We had to develop a business model for the future: The status quo was no longer successful, and the reform initiatives of my office forced us to examine the way we did our business – across the board. Difficult decisions were made, but these decisions ensured tax dollars were spent wisely and effectively.

Furthermore, I was committed to leaving our rural branch offices open. Much like the Postal Service, communities relied on local facilities; and simply closing offices that failed to make a profit was not an option. Local branch offices of Michigan's Department of State were forced to redefine the way they do business so that citizens were not forced to drive several hours simply to renew their drivers' licenses. In many communities, post offices act as the social epicenter – a meeting place where people discuss their lives and the hot topic of the day. To close a post office because a business case can not be made is unfair to rural citizens. The Postal Service must be granted flexibility to customize its delivery of services at a local level instead of relying on a business model that is over 30 years old.

The Postal Service is one aspect of the Federal government with which nearly every citizen conducts business; and without a financially sound Postal Service, Americans face needlessly inflated postal rates. This amounts to nothing less than a tax brought on by government waste.

The mailing industry accounts for 9 million jobs, 900 billion dollars in commerce and 9% of the United States gross domestic product. A needless increase in postal rates caused by the status quo would cost businesses hundreds of millions of dollars. The Postal Service must have greater flexibility, and enhanced oversight must be established so that postal rates are set at the right level. After all, the goal of postal reform is to guarantee the Service's long-term financial viability.

Congresswoman Candice S. Miller
Special Panel on Postal Reform and Oversight
Committee on Government Reform
Opening Remarks
Tuesday, January 27, 2004

Another important goal of postal reform should be enhanced transparency, which was one of the five priorities outlined by President Bush. Many Americans would be mystified to learn that uncovering details about the operations of the Postal Service are comparable to finding a needle in a haystack. Because the Postal Service is a government entity, information on its receipts and outlays should be publicly and easily available. There exists great waste at the regional and local levels within the post office, affirming the need for extensive oversight and enhanced transparency. There must be accountability, and proper oversight will help ensure the Postal Service is maximizing its resources.

Mr. Chairman, for 8 years you have led reform efforts; and I hope this is the year something gets done. President Bush has provided his support, and the report of the President's Commission on Postal Reform is a step in the right direction. I agree with many of its findings and conclusions and disagree with others, but the foundation has been laid. The Postal Service itself has done a very good job reducing costs, and I commend Mr. Fineman and Mr. Porter for their contributions. With Civil Service Retirement System Funding reform, we have begun the process of postal reform. Now is the time to finish the job.

I want to thank all of the witnesses testifying today. I look forward to your testimony.

Thank you.

ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM—PART II

THURSDAY, FEBRUARY 5, 2004

HOUSE OF REPRESENTATIVES,
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The special panel met, pursuant to notice, at 12:56 a.m., in room 2525, Dirksen Federal Courthouse, 219 South Dearborn Street, Chicago, IL, Hon. John M. McHugh (chairman of the special panel) presiding.

Present: Representatives McHugh, Schrock and Davis.

Staff present: Jack Callender, counsel; Brien Beattie, deputy clerk; Allyson Blandford, office manager; and Michael Layman, professional staff member.

Mr. MCHUGH. Particularly because we have our first panel of esteemed witnesses, no one would object if we gavel in a few minutes early. Two words, snow storm, four words, airplane. I know that is one word, but I think we want to make sure that we have the opportunity, as much time as possible to hear from our distinguished panelists in a way that provides opportunity for those who may have other destinations this evening to make those.

So first of all let me thank all of you in the audience and certainly our presenters, our witnesses, for joining us. I should say particularly it is a thrill to be here once again in the hometown as I understand it, actually the home district, of our ranking member, my friend and partner in this thing called postal reform for a few years now, Congressman Danny Davis. Danny, thank you for your hospitality, sir. You have a nice place here, I have to say.

The last time, as I mentioned, that I came to Chicago, was for a postal hearing as well. That was in October 1996. The subject of that was the, shall we say, less than optimal mail service that was being experienced in the city and now, nearly 7½ years later, while we are here clearly to discuss the future of the Postal Service and where the Postal Service itself goes tomorrow and the day after, it is important to note that the mail service quality that we came to hear about those 7 plus years ago has dramatically, dramatically improved. And I do not think there is any question as to how that has happened. Certainly the main reason for those strides in mail service improvements are the hundreds and thousands of men and women who are represented by our witnesses here today.

You can argue, as my opponents do every even numbered year, that I do not know much, but there is one thing I know for certain and certainly something that became clearly obvious to me coming

out of that first Chicago hearing. The key to universal service, the key to our universal and uniform pricing provisions for all Americans wherever they might live, the most important fact in America is enjoying the most affordable, reliable, service-oriented mail system found anywhere on the planet is the work of the professional postal employees and the facilities out on the routes stretching to every corner of every community in this great land.

And as we undertake the effort to try to make necessary changes to the Nation's postal laws, I certainly never do, and I hope none of us ever want to take for granted and never forget those that not only make the system work but understand too how important the mails are to every U.S. citizen. Even if every American, because of their busy schedules, really never gives much thought to that fact themselves, have never really had to, because the postal employees always have been there and I suspect, and it is a dangerous thought, in their minds that postal employees will always be there no matter what. And that is why we are here today, to ensure that happens, because without, in my opinion, some definitive actions soon that may not be the case.

And I welcome—we have two esteemed panels of witnesses for this second in a series of three hearings entitled, "Answering the Administration's Call for Postal Reform." The presidents of all four postal unions and three management associations have made the journey here to Chicago. We are honored, gentlemen, by your effort to be here and your presence and your concerns. And I think it is important to stress the gravity of the matter that faces us today.

The Postal Service is the focus, is the source, of nearly $900 billion in industrial activity. We have talked a lot about economic development and economic activity. The Postal Service, $900 billion is what it represents and it employs 9 million workers nationwide, and it represents some 8 percent of the entire domestic product of the United States of America. That is an incredible figure—8 percent—and in my opinion the Postal Service is in trouble and it requires reform legislation to prevent a meltdown. I believe there is a good reason why this is the first administration since Richard Nixon to call on Congress to modernize our postal laws. I remain hopeful as Congress did back in 1970 that we too and this panel and in this Congress will do so in 2004 and answer the President's charge.

And last week we heard from the Postal Service itself, we heard from the administration, we heard from the Rate Commission, we heard from the General Accounting Office [GAO]. And we heard that universal postal service is at risk and reform is needed to minimize the danger of significant taxpayer bailout or dramatic postal rate increases. While Congress provided last year—and I think in a very important step—a bit of financial breathing room for the Postal Service when we reduced its payment for pension obligations, the fundamental challenge, fundamental problem, remains unchanged and that is that the Postal Service's current business model is not sustainable going into the 21st century.

And last week at that hearing I mentioned, we heard the Postal Service still faces about a $90 billion obligation liability despite passage of the pension bill last year. Total mail volume declined for the third year in a row. It is a historical first for the Postal Service,

which has depended on larger mail volume year in and year out to help to cover the cost and cover rising costs and mitigate rate increases. First class mail volume declined by 3.2 percent in 2003, and it is projected to continue to decline for the foreseeable future. And this is particularly serious because first class mail revenues cover more than two thirds of the overhead cost of the U.S. Postal Service. And as GAO noted, the Postal Service's revenues are budgeted for zero, no growth, flat line growth in 2004. And should that happen, it would be the first time since postal reorganization in 1970 that postal revenues had failed to increase.

Those are just the highlights, some would understand we call them the low lights, of the problems which disturbingly go on and on. Changes in the mail mix, increased competition from private delivery companies, declining capital investment, insufficient increases in postal productivity, uncertain funding for emergency preparedness as we have seen in the past several days in Washington with now not anthrax but ricin poisoning possibly, maybe probably, in the mail. And major challenges continu to continued cost cutting.

While the problems are dire, I think the administration's principle for legislative changes show us a path, show us some solutions that can build on the now more than 8 years of this postal reform committee, and fortunately we have a strong bipartisan basis upon which to proceed, including the well-refined bill that Congressman Davis and I and Congressman Waxman, Congressman Burton and Congressman Tom Davis helped put together in the last Congress. And the Postal Service is too important an institution to our economy to await the full brunt of a crisis that is clearly upon our doorstep. And over the past 9 years, the structure of this oversight body has changed. We have been a full committee, a subcommittee, a special panel. But whatever you call us, our goal has remained constant: to try to address those issues that confront the postal employees today, and plan for timely action on those challenges that lie ahead. And there is no greater matter confronting the Service than the future of our Nation's postal system.

So, with that I would like to thank all of our witnesses for appearing. I want to particularly appreciate Congressman Ed Schrock, the gentleman from Virginia, who made the long trip here to join us. Ed, good to see you. Obviously, through his mere presence he shows his commitment and concern about this. And most of all, I would like to yield to, as I said, my partner in this process and someone who has been as devoted and some say as headstrong in this effort as I have. I mean that as a compliment, Danny. I am not sure everybody would but, Danny Davis.

Mr. DAVIS. Thank you very much. You know, Mr. Chairman, no matter what the structure—I was thinking that you have been there whether it was a full committee, subcommittee or a special panel, you have been there leading the way, and I want to commend you for your steady, long, tedious attention to these matters and to these issues. And I also want to thank you and Congressmen Schrock for coming to Chicago. It is not everybody who would want to come to Chicago February 1st. It is indeed an inviting city, but it also has some characteristics—we have a lot of things to offer—Wrigley Field, Soldier Field, Marshall Field, and we have

some wind that blows, but it is still Chicago and we are delighted that all of you are here.

I also want to thank all of those who have come as witnesses to discuss issues concerning postal reform. I am pleased to welcome you and note that this is the second in a series of meetings to consider the need and prospect for postal reform. We began the 108th Congress on a very positive and productive note. We passed and subsequently enacted into law legislation correcting the calculations of postal payments to the Civil Service Retirement System. As consumers and members of the postal mailing community know, this change in postal pension law allowed the Postal Service to reduce its outstanding debt and hold postage rates steady until 2006. The Postal Service received a financial break and so did the public. As we begin the second session of the 108th Congress, obviously we have a great deal of additional work to do.

First, because of the fact that we created an escrow account in the postal pension law, the Postal Service must provide us a workable plan on its capital investments for our productivity gains and cost saving initiatives. I am pleased to note that the plan was delivered a couple of days ago. As for postal reform efforts, we are now moving at a positive pace, picking up on a much more positive note than where we left off in the 107th Congress. Using Chairman McHugh's Postal Reform Bill, H.R. 4970, as a starting point, we are working on establishing a strong foundation for reform. To date, our staffs have met with several postal stakeholders to solicit their recommendations for positive changes. In addition, the recommendations submitted by the President's Commission on the Postal Service in July 2003 and the administration's principles for postal reform are critical to the process. I look forward to hearing the testimony from our outstanding labor unions represented in addition to our witnesses' thoughts on the Presidential Commission's recommendations, and I look forward to hearing about whether we have done a good enough job in making sure that postal employees are safe from biological hazards like anthrax or ricin.

Moreover, I am concerned with the issue of excesses. I am also pleased that both the House and Senate are fully engaged in the issue of postal reform. It is my hope that with continued bipartisan support and the leadership you have all demonstrated that we will obtain the goal of assuring that our postal system continues as an effective instrument, as an effective vehicle through which people in this country can continue to communicate.

Mr. Chairman, again I thank you for coming to Chicago, I thank all of those who have been involved in getting us to this point, and look forward to the testimony of our witnesses.

Mr. MCHUGH. Thank you very much, Danny. I cannot tell you how very much I appreciate the devotion you have brought to the subject. We have been up and down and around, and through it all the one constant has been you sitting there trying to do the right thing. And it is an admirable quality and I am proud to call you my partner in this.

I would be delighted to yield now to a gentleman, as I said, who made a particular effort to be here today, a good friend of mine and a great American and a great Virginian, the gentleman from Virginia, obviously, Mr. Schrock, Ed.

Mr. SCHROCK. Thank you, Mr. Chairman, thank you for holding this second hearing on the administration's call for postal reform. Danny Davis said if I would be willing to come here he could guarantee me some warm weather. But I guess I am going to have to come back for that. Two of my closest friends, both of whom were in my wedding, live in Naperville, my wife has an aunt and an uncle that live in the Chicago area. So, I do know you have good weather and I think I am going to have to come back for that.

Thank you also to the witnesses for being with us today to provide your organizations' views on the Commission's report and the next process and the next steps in the postal reform process.

As we all know, tackling postal reform is no easy task. Every American is a stakeholder in the viability and future of the Postal Service and thousands of American companies rely on the Postal Service to do business. But the men and women at the Postal Service who provide the services that keep our mail moving are a valuable commodity and I look forward to hearing from their representatives today.

The President's Commission focused a great deal in their report on right-sizing the Postal Service and its processes, including adopting a faster and simpler rate-setting process, consolidation and rationalization of the postal facility network, and developing an appropriately sized work force at all levels of the postal work force structure. After reading through your testimony, it is clear that you and your members do not agree with all the Commission's recommendations, and I know that you and I will probably disagree on a number of their recommendations. But I think there is a great deal of room where we can work together to implement legislation that will benefit the future of the Postal Service, its employees, and the postal customers, and frankly, I would not have traveled here today if I did not think so. I could have been home in Virginia Beach where it is not much warmer, but a little bit warmer. So, I look forward to your testimony today and a healthy dialog about how we can ensure a positive and thriving future for our Postal Service.

And again thank you, Congressmen Davis, for welcoming us here, and thank you, Mr. Chairman, for holding this second hearing.

Mr. MCHUGH. Thank you, sir. In the interest of full disclosure I want to say two things: One, I came here for the good weather: my district borders Canada and 2 weeks ago it was 42 below zero; this is beach weather, I think Chicago is. Second of all, I think every politician has dreams and every politician has nightmares. My nightmare is when I wake up sitting where these gentlemen are in a Federal courthouse having to take an oath of office. So, it is good to be awake and the reason I say that is that these gentlemen know we now have to take an oath to actually begin the hearing as it is committee policy. If the gentlemen will rise, I will administer the oath. Raise your right hands please.

[Witnesses sworn.]

Mr. MCHUGH. The record will show that all the witnesses responded in the affirmative. We are not going to turn on the light yet, we are going to do that when we get to the questions and answers, which is, as I am sure most of you know, the 5-minute limit.

We have all of the written statements from both panels here today and, without objection, I would ask they all be entered into the record in their entirety. Hearing no objection, so ordered.

Gentlemen, to the extent it is possible, we would ask you to summarize your comments, but however you choose to proceed we are very grateful for your presence here today; most importantly, grateful for your leadership and for the membership that you represent, who are, as I tried to indicate in my opening statement, some amazing people doing an incredible job. Thank you for your service, thank you for being here and we are very anxious to hear your comments. I imagine—oh, there it is. Thank you, Robert, we have to read them as they are written here. The first panel—and as I am quickly scanning I believe that it is going from my left to right, from the audience's right to left—Mr. William Burrus, president of the American Postal Workers Union; good to see you. Mr. William Young, president of the National Association of Letter Carriers; thank you for being here. Mr. Dale Holton, who is president of the National Rural Letter Carriers Association, someone I am familiar with and his people. Mr. John Hegarty, who is national president, National Postal Mail Handlers Union; John, thank you. Gentlemen all. It makes sense to me that we begin with testimony as we presented you, so with that, Bill, we would be anxious to hear your comments, sir, and welcome.

STATEMENTS OF WILLIAM BURRUS, PRESIDENT OF AMERICAN POSTAL WORKERS UNION, AFL–CIO; WILLIAM H. YOUNG, PRESIDENT OF NATIONAL ASSOCIATION OF LETTER CARRIERS; DALE HOLTON, PRESIDENT OF NATIONAL RURAL LETTER CARRIERS ASSOCIATION; AND JOHN HEGARTY, NATIONAL PRESIDENT OF NATIONAL POSTAL MAIL HANDLERS UNION

Mr. BURRUS. Thank you, and good afternoon, Mr. Chairman and members of the special panel. Thank you for providing me this opportunity to testify on behalf of the more than 300,000 members of the American Postal Workers Union. Arguably, the APWU is the largest single bargaining unit in the country, and we appreciate your foresight in addressing the structural weaknesses of the Postal Reorganization Act as applied to conditions in the present and beyond. In response to the chairman's request that we limit our remarks to 5 minutes, I have abbreviated my oral testimony but ask that the full statement be entered into the record.

This hearing is called to review the current state of postal services, and to consider legislative change to ensure its viability far into the future. Over the past 3 years, mail volume has declined, and there is concern over the future of first class mail. The generally accepted view is that the expanded use of technology has been and will be at the expense of hard-copy communications. Our union shares the concern of the mailing community, but we caution against drawing firm conclusions based upon the experiences of the past 3 years.

But, whether mail volume increases or decreases, the need for a viable Postal Service will continue. Despite the effects of Internet communications, facsimile machines, and the telephone, the unifying role of the Postal Service will be critical. But while others are

absolutely certain of the future, I offer a note of caution. At this time, the facts simply do not support a conclusion that the Postal Service is in a death spiral.

We must remember that postal volume was affected by several national events. The first was the terrorist attacks of September 11, followed by the anthrax attack that took the lives of two postal workers, members of my union. The combined effects of the September 11 and anthrax attacks were superimposed over the recession that began in early 2001, and from which we are only now experiencing a relatively weak and inconsistent recovery. If one were to extract the impact of technological diversion, these events standing alone would have had a serious impact on postal volume. There are positive signs. The Postal Service recently reported that mail volume during the 2003 holiday mailing season increased sharply over the previous year, resulting in the highest volume period in the history of the Postal Service. Are we to believe that technological impact took a holiday this Christmas season, or are other factors at work?

I wish to make an important point on the subject of future mail volume and the impact on the Postal Service's ability to provide universal service. It is not the business model that determines the relative contributions to overhead cost of first class mail as compared to standard mail. As first class mail grows or declines, the question of dividing institutional costs among all classes of mail will remain. At present, it takes approximately three pieces of standard mail to make up for one piece of first class mail. This distribution of costs is a rate-setting decision that will be unresolved by postal reform.

In your invitation to testify today, you asked that I pay particular attention to the five principles outlined by the administration, and I will. Clearly, there is a consensus that the Postal Service performs a vital public service, and that it must be preserved and maintained. However, it is difficult to tell from the five principles what specifically the administration supports. Our union supports the broad principles of the administration, but as they say, the devil is in the details. We have some very strongly held views about how the principles must be carried out, and we are aware that others believe that these same principles justify changes which we adamantly oppose.

The first principle stated by the administration is that we should, "Implement best practices that ensure that the Postal Service governing body is equipped to meet the responsibilities and objectives of an enterprise of its size and scope." We find little to disagree with the direction to implement best practices in managing and operating the Postal Service. Many private and public entities have adopted practices that should be considered by the Postal Service, while taking into account the unique role of this government entity and its role in binding our Nation together.

The relevant question is, what are the best practices that should be adopted to preserve and protect the Postal Service? Some who propose what they call best practices have advocated regressive labor policies that would roll back the clock to 1970. The report of the Presidential Commission includes a number of such recommendations, which we adamantly oppose.

It is completely inconsistent and totally unacceptable for the Commission to espouse a commitment to collective bargaining while simultaneously recommending that postal compensation be dictated by an appointed board. The Commission seems to believe that postal workers are fools. The following disingenuous platitudes appear in the report: "Plans for modernizing the Nation's postal network must effectively utilize the Postal Service's most valuable asset, it employees." "Essential to this process is the ability of management and labor to work constructively together." "First and foremost, the Postal Service management must repair its strained relationship with its employees."

Those are fine statements but in contrast to those statements, the Commission's specific recommendations are an invitation to open conflict with postal employees. The report paid lip service to the importance of good labor relations, while making recommendations that would ensure labor conflict.

The Commission also urged Congress to consider removing postal employees from Federal retirement and retiree health care plans. This would be a diametric departure from appropriate public policy. We categorically reject the contention that it would be appropriate for postal employees, now or in the future, to be paid fringe benefits that are less than those provided to other Federal employees. In recent years, postal workers have repeatedly stood on the front line of homeland security. When hired, they must submit to background checks and fingerprinting, and they are administered a Federal oath of office. It would be an insult to their courage and dedication to suggest that they should be afforded anything less than Federal status. Health benefits, whether for active workers and their families, or people injured on the job, or retirees and their families, are very powerful and emotional issues. It would be a callous act to reduce the health benefits of postal workers injured by anthrax, to reduce their injury compensation benefits, or to reduce the benefits of the widows of the workers killed by anthrax.

The administration also has endorsed the principle of transparency, "Ensure that the important factual information on the Postal Service's product cost and performance is accurately measured and made available to the public in a timely manner." In a democracy, government agencies have a fundamental obligation to function with the consent of the government, which could only be achieved through the public sharing of information. However, transparency cannot be used to place the Postal Service at a competitive disadvantage. Postal competitors must not be permitted to use transparency as a means of competing unfairly or unduly influencing decisions that are central to a healthy and effective Postal Service.

The third principle endorsed by the administration is flexibility, "Ensure that the Postal Service's governing body and management have the authority to reduce costs, set rates and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace." We believe that barriers that prevent the Postal Service from adjusting to the marketplace should be reviewed and adjusted accordingly. To permit the Postal Service to grow in the future, we support flexible rate setting, giving postal management the authority to design and introduce new products

and freedom to borrow, invest, and retain earnings. In the area of work force flexibility, however, we urge Congress to be extremely careful about imposing its judgment on postal management and the unions.

The fourth principle is accountability, "Ensure that a Postal Service operating with greater flexibility has appropriate independent oversight to protect consumer welfare and universal mail service." No one will quarrel with the suggestion that there should be an appropriate independent oversight of the Postal Service. We expect that there will be many disagreements, however, over what type of oversight is appropriate. We have serious reservations about the creation of a postal regulatory board with broader power than the present rate commission. In our view the Board of Governors should be strengthened and made more effective in its management oversight, and importantly, the consumer advocate should be afforded appropriate independence. If rate-setting is made more flexible, as we think it must be, certainly there must be an appropriate watchdog agency where interested parties can take complaints about alleged abuse or violations of the law. Employees are and have always been held accountable for their actions.

The fifth principle is self-financing, "Ensure that a Postal Service operating with greater flexibility is financially self-sufficient, covering all its obligations." For the past 33 years, the Postal Service has been a powerful financial engine that has more than sustained itself through times of enormous growth and change. During the 1980's and early 1990's, Congress imposed billions of dollars of cost on the Postal Service that had no relation to its operations. This cannot be repeated.

We are informed that the Office of Personnel Management is now seeking to impose an $86 billion liability on the Postal Service for retirement benefits for workers with Federal service credits. This act is inconsistent with the administration's statement of broad support for postal reform. The same can be said of seeking to shift the cost of military retirees or forcing the Postal Service to escrow the funds it has overpaid to the CSRS fund. Using the Postal Service as a cash cow to help reduce the Federal deficit is a luxury the American ratepayer can no longer afford.

This brings me to what I consider a most important point for the Congress to understand about Postal Service financial self-sufficiency. The Postal Service is currently giving away hundreds of millions of dollars every year in the form of excessive worksharing discounts. Postal data show that discounts provided to major mailers exceed the cost avoided by the Postal Service. It is not possible to create a business model for a healthy Postal Service if the rate-setting process continues to hemorrhage hundreds of millions of dollars a year.

There are a number of discounts that should be reduced to bring them into line with costs avoided. These include: First class non-automation pre-sort discounts; standard A three to five digit pre-sort discount; standard A automation discounts; and first class automation discounts.

This problem was tacitly acknowledged by the Presidential Commission in its recommendation that all future discounts be limited to the costs avoided. That is simply not good enough. That horse

has left the barn and we need to get it back to preserve universal service in the public interest.

Some interested parties, when confronted with the fact that discounts cannot be justified, have responded by calling for bottom up pricing. This radical concept, which purports to establish a system whereby mailers pay only for the service they use, would actually relieve the largest mailers of any responsibility for the cost of maintaining a universal system. It would almost certainly result in surcharges for services to rural communities and low volume post offices. Such a structure would be tantamount to proposing that public education be funded only by those who have children in school.

In conclusion, the American Postal Workers Union supports the broad principles of the administration, but we reserve our position on the details. We also wish to emphasize the importance of addressing the most immediate concerns. For long term financial solvency, the Postal Service must be relieved of the burden of paying for military retirement and must be permitted to make appropriate use of the savings from the recalculation of its CSRS contributions. In addition, OPM's effort to shift Federal service retirement costs to the Postal Service must be addressed. This adds up to $27 billion for military retirees, $10 billion for the escrow account, and $86 billion in the Federal service retirement costs. In applying the principles supported by the administration we trust that these issues will receive favorable consideration. Because if the objective is to stabilize the Postal Service and secure its future this is where the process must begin.

Thank you, Mr. Chairman, and thank you once again for the opportunity to present testimony today, and I will be pleased to answer questions after my colleagues have their opportunity to make their remarks.

Mr. McHugh. Thank you, President Burrus, appreciate your insights and your thoughts.

Next, Mr. William Young who is president of the National Association of Letter Carriers. Bill.

[The prepared statement of Mr. Burrus follows:]

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Before The

SPECIAL PANEL ON POSTAL REFORM
HOUSE COMMITTEE ON GOVERNMENT REFORM

Testimony Of

WILLIAM BURRUS, PRESIDENT
AMERICAN POSTAL WORKERS UNION, AFL-CIO

(February 5, 2004)

Congressional Testimony

Good afternoon, Mr. Chairman and members of the Special Panel. Thank you for providing me this opportunity to testify on behalf of more than 300,000 members of the American Postal Workers Union. The APWU is the largest single bargaining unit in the country, and we appreciate your foresight in addressing the structural weaknesses of the Postal Reorganization Act as applied to conditions in the present and beyond.

This hearing is called to review the current state of postal services, and to consider legislative changes to ensure its viability far into the future. Over the past three years, mail volume has declined, and there is concern over the future of first-class mail. The generally accepted view is that the expanded use of technology has been and will be at the expense of hard-copy communications. Our union shares the concerns of the mailing community, but we caution against drawing firm conclusions based upon the experience of the past three years.

Whether mail volume increases or decreases, the need for a viable Postal Service will be important to our country. Despite the effects of Internet communications, facsimile machines, and the telephone, the unifying role of the Postal Service is still critical.

A study released in 2003 by the Pew Internet and American Life Project concluded that 42 percent of Americans do not use the Internet. Sixty-two percent (62%) of Americans with disabilities do not use the Internet; racial and ethnic minorities, the elderly, and less well-educated Americans are also less likely to use the Internet. If the Postal Service were not available, the deepening divide between the well-off and the not-so-well-off would be much worse. Millions of Americans still rely on the Postal

Service, because they must. For these Americans, there is no alternative to affordable universal service.

And companies both large and small that are not tied to the mailing industry rely on the Postal Service to conduct business. Their interest in a stable, reliable postal network that provides universal service at uniform rates cannot be overlooked.

We must be assured that postal services continue to be available, no matter the outcome of the possible shift in communications. Therefore, the American Postal Workers Union supports changes to the Postal Reorganization Act that will strengthen the Postal Service. Before discussing those changes further, however, I want to pause to observe that we do not share the view that there is necessarily a major crisis in this industry.

While others are absolutely certain of the future, I offer a note of caution. At this time, the facts simply do not support a conclusion that the Postal Service is in a death spiral.

We must remember that postal volume was affected by several national events. The first was, of course, the terrorist attacks of 9/11. That was followed by the anthrax attack that took the lives of two postal workers.

The combined effects of the 9/11 and anthrax attacks were superimposed over the recession that began in early 2001, and from which we are only now experiencing a relatively weak and inconsistent recovery. If one were to extract the impact of technological diversion, these events still would have had a serious impact on postal volume.

There are positive signs. The Postal Service recently reported that mail volume during the 2003 holiday mailing season increased sharply over the previous year, resulting in the highest volume period in the history of the Postal Service. Are we to believe that technological impact took a holiday this Christmas season, or are other factors at work?

As you are aware, Congressional action to limit telephone solicitations, along with a renewed concern over e-mail spam are having a positive impact on hard-copy advertising, and are expected to lead to increased mail volume. It is simply too early to make definitive projections on the future of hard-copy communications.

While e-mail and the Internet are increasingly used as communication tools, the expansion of technology is not new. The telegraph and the telephone, for example, were equally progressive at the time of their development. So we must be careful not to assume too much about the impact of today's new technologies on hard-copy communications.

And I wish to make an important point on the subject of future mail volume and the impact on the USPS ability to provide universal service. The current business model is not responsible for the relative contribution level of first-class compared to standard mail. Even if first-class mail continues to grow, despite the inroads of technology, the question of dividing institutional costs among all classes of mail will remain. At present, it takes approximately three new pieces of standard mail to make up for the loss of one piece of first-class mail. This distribution of cost is a political decision that will be unresolved by postal reform. So, even with robust mail growth far

into the future, postal rate setters must revisit the distribution of cost, with or without postal reform.

In your invitation to testify today, you asked that I pay particular attention to the five principles outlined by the Administration, which expressed its general support for the recommendations of the President's Commission.

Clearly, there is a consensus that the U.S. Postal Service performs a vital public service, and that it must be preserved and maintained. Beyond that, however, it is difficult to tell from the five principles what, specifically, the Administration supports. The American Postal Workers Union also supports the broad principles stated by the Administration; but the Devil, as they say, is in the details.

We have some very strongly-held views about how the principles supported by the Administration must be carried out, and we are aware that others believe that these same principles justify changes which we adamantly oppose.

The first principle stated by the Administration is that we should:

> ***Implement Best Practices.*** *Ensure that the Postal Service's governing body is equipped to meet the responsibilities and objectives of an enterprise of its size and scope.*

We find little to disagree with in the direction to implement best practices in managing and operating the Postal Service. Many private and public entities have adopted practices that should be considered by the Postal Service, while taking into account the unique role of this government entity and its role in binding the nation together.

The relevant question is, What are the best practices that should be adopted to preserve and protect the Postal Service?

Some who propose what they call "best practices" have advocated regressive labor policies that would roll back the clock to 1970. The Report of the Presidential Commission on the Postal Service includes a number of such recommendations, which we adamantly oppose.

The Report repeatedly states that the Commission supports the right of postal workers to engage in collective bargaining. Nevertheless, it recommends the establishment of a three-member Postal Regulatory Board, appointed by the President, which would have the authority to set the compensation of postal employees.

It is completely inconsistent, and totally unacceptable, for the Commission to espouse a commitment to collective bargaining while simultaneously recommending that postal compensation be dictated by an appointed board, separate and apart from the collective bargaining process.

The Commission seems to believe that postal workers are fools. The following disingenuous platitudes appear in the Commission's Report:

> "...plans for modernizing the nation's postal network...must effectively utilize the Postal Service's most valuable asset – its employees."

> "Essential to this process is the ability of management and labor to work constructively together to determine the right size of the postal workforce and to ensure appropriate flexibilities in its deployment. This is *the* critical issue when it comes to controlling the future costs and capabilities of the workforce. Far more than individual benefits, the *size* of the workforce determines the *costs* of the workforce."

> "First and foremost, Postal Service management must repair its strained relationship with its employees."

In contrast to these statements, the Commission's specific recommendations are an invitation to open conflict with postal employees. The Report paid lip service to the importance of good labor relations, while making recommendations that would ensure labor conflict.

The Commission's recommendations to change the collective bargaining process are unwise and would be counterproductive. Current law permits the parties maximum flexibility in their efforts to resolve their differences. The system has stood the test of time. It has resulted in labor costs that have tracked the increase in the Consumer Price Index and the Employment Cost Index since 1984. Those who criticize this record are, in effect, asking postal workers to take a cut in real wages. Needless to say, that is unacceptable.

The Commission also urged Congress to consider removing postal employees from federal retirement and retiree healthcare plans. This would be a diametrical departure from appropriate public policy. We categorically reject the contention that it would be appropriate for postal employees, now or in the future, to be paid fringe benefits that are less than those provided to other federal employees.

In recent years, postal workers have repeatedly stood on the front lines of homeland security; when hired they must submit to background checks and fingerprinting, and they are administered a federal oath of office. It would be an insult to their courage and dedication to suggest they should be afforded something less than federal status.

The same is true of workers' compensation benefits. These minimum benefits

are not negotiable, nor should they be. It would be indecent for the Postal Service to seek to impose substandard retirement benefits, retiree health benefits, or workers compensation benefits on postal employees.

In this debate over the cost of health benefits, forgotten is the fact that rising healthcare costs are due in part to a large number of uninsured or underinsured Americans. This is not a failure of bargaining, but an important public policy problem that cannot be solved by shifting costs from employers to employees or retirees.

Health benefits, whether for active workers and their families, for people who have been injured on the job, or for retirees and their families, are a very powerful and emotional issue. It would be a callous act to reduce the health benefits of postal workers injured by anthrax; to reduce their injury compensation benefits, or to reduce the benefits of the widows of the workers killed by exposure to anthrax.

The Administration also has endorsed the principle of:

> ***Transparency.*** *Insure that important factual information on the Postal Service's product costs and performance is accurately measured and made available to the public in a timely manner.*

In a democracy, government agencies have a fundamental obligation to function with the consent of the governed, which can only be achieved through the public sharing of information. However, transparency cannot be used to place the Postal Service at a competitive disadvantage. Postal competitors must not be permitted to use transparency as a means of competing unfairly or unduly influencing decisions that are central to a healthy and effective Postal Service.

We are aware that UPS and other postal competitors claim an ability to attribute

or allocate virtually all of their costs, whereas the Postal Service does not do this. We, too, have an interest in this issue, because we believe that accurate cost attribution would further demonstrate that worksharing discounts are too large. On the other hand, there are significant differences between the Postal Service and its competitors, the most important being the commitment to universal service. Those who advocate "bottom-up" pricing of postal services may seek to use further cost allocation to support their efforts to cut their own postal rates. Our concern is that transparency must be used in the public interest, which is to say in the interest of strengthening the Postal Service.

The third principle endorsed by the Administration is:

> ***Flexibility.*** *Ensure that the Postal Service's governing body and management have the authority to reduce costs, set rates and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.*

We believe that barriers that prevent the Postal Service from adjusting to the marketplace should be reviewed and adjusted accordingly. To permit the Postal Service to grow in the future, we support: flexible rate-setting; giving postal management the authority to design and introduce new products; and giving management the freedom to borrow, invest, and retain earnings.

In the area of workforce flexibility, however, we urge Congress to be extremely careful about imposing its judgment on postal management and the unions. While all of the labor unions and management associations have negotiated contractual terms governing the movement of employees, there are no contractual prohibitions on the

expeditious movement of employees between assignments to accomplish the primary task of processing mail expeditiously. These procedures have been hammered out by the parties over the past 100 years. In recent years, these provisions have not been the subject of recommendations for change. Who is in a better position to determine the appropriate balance between management flexibility and the needs of workers than the parties themselves?

The fourth principle endorsed by the Administration is:

> ***Accountability,*** *Ensure that a Postal Service operating with greater flexibility has appropriate independent oversight to protect consumer welfare and universal mail service.*

No one will quarrel with the suggestion that there should be appropriate independent oversight over the Postal Service. We expect there will be many disagreements, however, about what type of oversight is appropriate. We have serious reservations about the creation of any Postal Regulatory Board with broader powers than the present Postal Rate Commission. In our view, the Board of Governors of the Postal Service should be strengthened and made more effective in its management oversight, and the Consumer Advocate should be afforded appropriate independence.

If rate-setting is made more flexible, as we think it must be, certainly there must be an appropriate watchdog agency where interested parties can take complaints about alleged abuse or violations of law.

Employees are and have always been held accountable for their actions. The Postal Service disciplines employees at a higher rate than most other employers. The

American Postal Workers Union vigorously defends the rights of employees, and when action is taken against an employee that does not meet the "just cause" standard, we apply all of our resources to their defense.

Employees and the union expect rules to be reasonable and just, administered consistently and fairly.

Similar standards of accountability are not applied to managerial decisions, however, and too often employees witness the most serious abusers being rewarded. Over a five-year period, I have asked the Postal Service to look into specific examples of abusive employment practices, but they have failed to do so. This is an area where accountability of management needs to be strengthened.

The fifth principle endorsed by the Administration is:

> ***Self-Financing.*** *Ensure that a Postal Service operating with greater flexibility is financially self-sufficient, covering all its obligations.*

For the past 33 years, the Postal Service has been a powerful financial engine that has more than sustained itself through times of enormous growth and change. During the 1980s and early 1990s, Congress imposed billions of dollars of costs on the Postal Service that had no relation to its operations. The Postal Service withstood those challenges and prospered.

We understand that the U.S. Office of Personnel Management (OPM) is now seeking to impose an $86 billion liability on the Postal Service for retirement benefits for postal workers with federal service credits. Speaking frankly, it seems to us that this action is inconsistent with the Administration's statement of broad support for postal reform.

The same could be said of seeking to shift the cost of military retirees, or forcing the Postal Service to "escrow" the funds it has overpaid to the CSRS fund. Using the Postal Service as a cash cow to help reduce the federal deficit is a luxury the American people can no longer afford. The Postal Service is still a very strong, viable institution, but it has its own problems and it should not be asked to shoulder the financial burdens of the federal government. Nor should postal rate-payers assume costs that should be paid by the taxpayer.

Worksharing Discounts

This brings me to what we consider a most important point for the Congress to understand about Postal Service financial self-sufficiency. The Postal Service is currently giving away hundreds of millions of dollars every year in form of excessive worksharing discounts.

Earlier, I spoke about Postal Service "best practices." We think a critical best practice that should be adopted is the proper pricing of postal products to ensure financial stability.

The Postal Service's own data show that discounts provided to major mailers exceed the costs avoided by the Postal Service These excessive discounts cost the Postal Service hundreds of millions of dollars in lost revenue every year. It is not possible to create a business model for a healthy Postal Service far into the future if the rate-setting process continues to hemorrhage hundreds of millions of dollars. Put simply, you cannot break even if you continue to give away hundreds of millions of

dollars in revenue each and every year.

There are a number of discounts that should be reduced to bring them into line with costs avoided. These include:

- First-Class non-automation pre-sort discounts;
- Standard A three/five-digit pre-sort discounts;
- Standard A automation discounts; and,
- First-Class automation discounts.

This problem was tacitly acknowledged by the Presidential Commission in its recommendation that all *future* discounts be limited to the costs avoided. This is simply not good enough. That horse has left the barn and we need to get it back to preserve universal service in the public interest.

Some interested parties, when confronted with the fact that discounts cannot be justified, have responded by calling for "bottom-up pricing." This radical concept, which purports to establish a system whereby mailers pay only for the services they use, would actually relieve the largest mailers of any responsibility for the costs of maintaining a universal system. It would almost certainly result in surcharges for service to rural communities and low-volume post offices.

Such a structure would be tantamount to proposing that public education be funded only by those who have children in school. The proponents of this radical approach – those who profit from the universal service network – are eager to avoid paying for it. A self-interested proposal like this is a natural and predictable position for any profit-motivated industry to take, but it cannot form a basis for public policy.

Ultimately, bottom-up pricing would destroy the Postal Service's financial self-sufficiency and require Congress to make a choice between public subsidies or the abandonment of universal service.

Conclusion

In conclusion, the American Postal Workers Union supports the broad principles of the Administration, but we reserve our position on the details. We also wish to emphasize the importance of addressing the most immediate concerns. For long-term financial solvency, the Postal Service must be relieved of the burden of paying for military retirement, and must be permitted to make appropriate use of the savings from the re-calculation of its CSRS contributions. In addition, OPM's effort to shift federal service retirement costs to the Postal Service must be addressed. This adds up to $27 billion for military retirees, $10 billion for the escrow account, and $86 billion in the federal service retirement costs. In applying the principles supported by the Administration, we trust that these issues will receive favorable consideration. If the objective is to stabilize the Postal Service and secure its future, this is where the process must begin.

Thank you, again, for the opportunity to present testimony today. I would be pleased to answer any questions you may have.

Mr. YOUNG. On behalf of the 300,000 active and retired city letter carriers across the Nation, thank you for this opportunity to share our views on the crucial issue of postal reform. NALC is the exclusive collective bargaining representative of approximately 220,000 letter carriers who work every day in every State and territory of the Nation. City letter carriers have a tremendous stake in the future of the Postal Service. For them postal reform is not simply a policy matter or even a political issue, it is a matter of great personal importance for themselves and their families. So I wish to thank Chairman Tom Davis, panel Chairman John McHugh, Congressman Henry Waxman, Congressman Danny Davis and all the members of the Special Panel on Postal Reform and Oversight for taking up once again this vitally important issue.

Over the past decade, my union has been urging Congress to pursue comprehensive postal reform. We have long recognized the need for a new business model for the Postal Service in the age of the Internet. Until recently the debate on postal reform has been largely confined to the House of Representatives. Progress has been slow, but thanks to your hard work and perseverance, both the White House and the Senate are now fully engaged on postal reform. As you know, the Bush administration recently issued a set of general principles for postal legislation. We support these principles and look forward to working with the leaders of both houses of Congress to achieve bipartisan postal reform in 2004.

Today, I would like to briefly address the big picture of postal reform before turning to the key work force issues that are the main topic of this panel's testimony. NALC believes that the Postal Service's unmatched ability to reach every household and business in America 6 days a week is a vital part of the Nation's infrastructure that is essential to the economic health of the United States. As such, it is important to take steps now to strengthen its ability to function in the face of tremendous technological change. We urge Congress to reject a feared downsizing strategy and to embrace an empowerment strategy for the Postal Service. The Postal Service should be given the commercial freedom it needs to maximize the value of the universal service network by adding services and working with its customers to find new uses of the mail to replace those uses that are now migrating to electronic alternatives.

Greater commercial freedom which involves flexibility over prices and the ability to strike partnerships to optimize the value of its network would allow the Postal Service to maximize revenues and control costs while retaining the value of universal service. We recognize this approach poses the difficult challenge of balancing commercial concerns and public service considerations. We believe it is possible to give the Postal Service the flexibility it needs while protecting the legitimate concerns of competitors, customers and the public at large.

Let me now turn to the main topic of this hearing, postal work force issues. Our starting point is pretty simple, collective bargaining is a fundamental right of all, and the Postal Reorganization Act of 1970 rightly established collective bargaining under the auspices of the NLRB. I would like to make a couple of general observations before suggesting some guiding principles on work force reform.

First, I would like to point out that collective bargaining in the Postal Service has been a resounding success. Since the Postal Reorganization Act was enacted, there has not been a single work stoppage or disruption in service as a result of labor relations. Given the fact that the Postal Reorganization Act was enacted in part at least as a result of a national postal strike in 1970, this 34 year record of peaceful labor relations should not be minimized. The fact is that collective bargaining has been a win-win-win proposition. Postal workers have achieved decent pay imperatives, taxpayers have saved billions through the elimination of direct and indirect taxpayer subsidies, and the mailers have enjoyed affordable postal rates.

Second, it is important to note that neither the postal unions nor postal management favor radical changes to the existing postal collective bargaining system. Given that all sides agree that mail delivery is an essential public service that should not be disrupted by lockout or strikes, a workable system for resolving collective bargaining impasses is essential. NALC believes the existing system of interest arbitration has worked extremely well.

Third, it is important to note that postal labor relations have improved dramatically in recent years. Three of the four unions now have labor contracts in place that were voluntarily negotiated. All four have made progress in reducing the number of workplace grievances using various mechanisms. These improvements occurred not because Congress or the GAO or any other outside party mandated them. They happened because the parties themselves worked very hard to find common ground and to seek ways to resolve mutual problems. Postmaster General Jack Potter and his team deserve credit for working with us to achieve this transformation. With these general points in mind, NALC urges you to abide by four principles when you consider reform of the collective bargaining system.

One, I urge you to follow the Hippocratic Oath: "First do no harm." The system we have is not perfect. Indeed no system is perfect. But the parties have learned to work with each other within the current framework. As I outlined above, the process has worked well for all concerned. At a time of great change for the Postal Service in other areas, labor stability is crucial.

Two, maintain the flexibility that is currently built into the law. The PRA contains specific but flexible timetables for negotiating contracts and resolving collective bargaining impasses. It also provides a menu of options for impasse resolution and gives the parties the flexibility to shape these options for use, when appropriate, as conditions change. Indeed, the unions at this table have at various times used mediation, fact finding, mediation-arbitration, mediation-fact finding in combination, and last best offer arbitration. In the face of constant change, the flexibility of the current law is a virtue.

Three, avoid politicizing the collective bargaining process. Congress or White House intervention in the process would be highly destructive. This would inevitably happen if a politically appointed regulatory board were injected into the negotiations process.

Four, avoid exposing the process to outside litigation. Subjecting the results of collective bargaining to litigation before a Postal Reg-

ulatory Board, as proposed by the President's Commission, would be disastrous to the process. Depending on the prevailing political winds of the day and the makeup of the regulatory board at any particular moment, either side might be tempted to try to obtain from regulators what they could not expect to achieve through good faith bargaining.

Finally, I wish to address a couple of specific issues that have arisen in the wake of the report of the President's Commission on the Postal Service—the direct negotiation of pension and health benefits, and changes to the system of interest arbitration. As you know, as employees of the Federal Government, postal employees are covered by one of two pension plans, and also allowed in the Federal Employees Health Benefits Program. Although eligibility for participation in these programs is automatic and is not subject to collective bargaining, it is important that you understand that the cost of such benefits figures very prominently in postal labor negotiations. In the area of health benefits, postal management and its unions already directly negotiate the share of premiums to be paid by workers and the Postal Service. And when it comes to negotiating wage increases, the rising cost of pensions is explicitly discussed by the parties. The so-called "roll up factor" for employee fringe benefits, the added cost of benefits when postal wages are increased, is never far from the negotiators' minds. And you can be sure that no interest arbitration panel employed over the past 20 years has been spared the evidence from both sides on the cost of health and pension benefits.

My point is this: Although the parties do not directly negotiate over all aspects of postal benefit costs, these costs are not ignored and they invariably affect the results of wage negotiations. Indeed, a close examination of postal wage trends over the last 25 years reveals that postal wages have increased nearly 15 percent less than wages in the private sector as measured by the Employment Cost Index. This wage restraint is a direct reflection of the effort of negotiators and interest arbitrators to restrain wage costs in the face of rising health and pension costs to the USPS, a trend, which you all know affects all American employers. Given this context, we do not believe that it is necessary to formally place health and pension programs on the collective bargaining table. The parties already effectively take these costs into account under the existing system.

Let me turn to one other work force topic raised by the President's Commission. That would be reform of the postal interest arbitration process. We believe these changes are unnecessary and counter-productive for a couple of very practical reasons. First, the Commission's proposal would discard 30 years of experience by the parties and require us to start all over again, under a radically different process. That is a prospect that would inevitably impose significant cost on both sides. Second, we believe the only workable changes to the system of collective bargaining must be developed and negotiated by the parties themselves, not externally legislated or mandated. Both parties must see this process as their process for the results to be legitimate. The existing system gives us the flexibility to share the dispute resolution process without outside intervention.

Allow me to add one last note on interest arbitration. We believe the existing dispute resolution system is fair and an acceptable alternative to the right to strike. I say this not because we always prevail when we go to interest arbitration; indeed, on more than one occasion we have lost. In the 1990's, an interest arbitration panel chaired by Richard Mittenthal adopted a USPS proposal to create a lower-paid temporary work force to handle the transition to full automation, and another panel chaired by Rolf Valtin increased the employees' share of health benefit premiums. I say it because, win or lose, my members know that the existing system gives us a fair shot on the merits, and therefore they accept the results as legitimate.

I want to conclude my testimony by repeating something I told the members of the President's Commission at its first public hearing in February 2003. Good labor relations must be built on trust and good faith between the parties. No amount of tinkering with the mechanics of the collective bargaining process will change that basic fact. At this moment of great challenges for the Postal Service, we have worked very hard with the Postmaster General to build trust between us and to improve the workplace culture in the Postal Service. Please tread lightly in these areas so as not to risk the progress we have made.

I offer the committee the full cooperation of the men and women who deliver the Nation's mail every day. Working together we can ensure that every American household and business will continue to enjoy the best postal service in the world for decades to come. Thank you very much.

Mr. MCHUGH. Thank you, President Young, and we all share that objective, and that is why we are all collectively here today. I appreciate your comments.

Next, Mr. Dale Holton, President of the National Rural Letter Carriers Association, Dale.

[The prepared statement of Mr. Young follows:]

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TESTIMONY OF

WILLIAM H. YOUNG, PRESIDENT
NATIONAL ASSOCIATION OF LETTER CARRIERS

before the

COMMITTEE ON GOVERNMENT REFORM'S
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT

February 5, 2004

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Chicago, Illinois

TESTIMONY OF
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Chicago, Illinois

Good afternoon. My name is William H. Young. I am the President of the National Association of Letter Carriers. On behalf of 300,000 active and retired city letter carriers across the nation, thank you for this opportunity to share our views on the crucial issue of postal reform.

NALC is the exclusive collective bargaining representative of approximately 220,000 city letter carriers who work in every state and territory of the nation. We are proud to be the best organized open shop union in the country as some 92 percent of all city carriers are voluntarily enrolled as members. Like the nearly 500,000 other postal employees represented by my colleagues appearing here today, city letter carriers have a tremendous stake in the future of the Postal Service. For them postal reform is not simply a policy matter or even a political issue, it is a matter of great personal importance for themselves and their families. So I wish to thank Chairman McHugh, Representative Tom Davis, Congressman Henry Waxman, Representative Danny Davis and all the members of the Special Panel on Postal Reform for taking up this vitally important issue.

Over the past decade, my union has been urging Congress to pursue comprehensive postal reform. In 1994, my predecessor as NALC President called for an overhaul of the Postal Reorganization Act. Since then we have made a sustained effort to educate our members and the public at large about postal reform. We have long recognized the need for a new business model for the U.S. Postal Service in the age of the Internet. As it has for more than 200 years, technology is changing the communications needs of the American people and the commercial needs of American economy. And as in the past, our nation's postal system must change to meet these needs.

A lot is riding on our ability to meet the changing needs of the country. The Postal Service lies at the core of a $900 billion mailing industry, a major slice of the U.S. Gross Domestic Product. If you take into account all the industries that rely on a healthy and reliable national postal service, which include printers and publishers, online merchants and direct marketers, the jobs of some 9 million Americans are at stake. Beyond that, the economic heath and viability of whole regions of the country where population density is low or where urban redevelopment is desperately needed, a healthy postal system is a vital part of the nation's infrastructure, as important as roads, power plants and other basic utilities.

Over the past 10 years, the debate on postal reform has been largely confined to the House of Representatives. For many of you this has been a lonely enterprise and progress has been slow. But thanks to your perseverance and the recent work of the President's Commission on the United States Postal Service, it now appears that the White House has endorsed your efforts to make postal reform a reality. NALC supports the general principles for reform recently outlined by President Bush and welcomes the renewed interest of key Senate leaders on this important issue. NALC looks forward to working with leaders of both Houses of Congress to achieve bipartisan postal reform in 2004.

Today I would like to briefly address the big picture of postal reform before turning to the key workforce issues that are the main topic of this panel's testimony.

As you all know, the basic challenge facing the USPS is that electronic communications are gradually replacing key segments of the First-Class Mail stream. That mail stream helps finance an ever-expanding universal delivery network. The Postal Service delivers to 140 million households and businesses six days a week, 10 times the daily deliveries of private companies like UPS and Federal Express. That extraordinary network and the capacity it gives to every citizen and business in the country to reach every other citizen and business in the country every day is invaluable. The Postal Service is, in short, a national treasure that is worth preserving.

How can we do that if the delivery network continues to grow every year by millions of addresses while traditional mail volume growth is flat or declining? Some say its time for privatization and deregulation. The American people strongly oppose these options and, after careful study, the President's Commission rightly rejected them. This leaves few options for Congress. It can "go back to the future" and ask taxpayers to directly subsidize postal services. It can simply downsize the Postal Service in an attempt to achieve cost savings that mirror the decline in postage revenues. Or it can give the Postal Service the kind of commercial freedom that would allow it to replace lost revenues with new sources of income and to optimize the value of the national delivery and post office network.

NALC urges you to opt for the last approach. Last week's report from the CBO on the growing federal budget deficit makes it clear that the first option is out the question – even if Congress were so inclined, the federal government simply does not have the funds to subsidize the USPS. Besides, there is no reason to throw away one of the great achievements of the Postal Reorganization Act: the huge savings to taxpayers that resulted in the elimination of such subsidies. The downsizing option is equally unappealing. Universal service – which includes deliveries six days a week and easy access to a nationwide network of post offices – is just too valuable to the country to give up. Downsizing is not a viable option – closing post offices and reducing services will only make our problems worse by driving more mail from the postal system. Affordable universal service is the key to the future health of the nation's postal system.

So the answer is to give the Postal Service and its employees the tools to make the Postal Service more valuable to mailers and to the country. That means giving the USPS greater flexibility to set its prices and the ability to partner with other companies to offer new services and/or to use its network to satisfy the needs of America's citizens and its

millions of businesses. Greater commercial freedom would allow the USPS to maximize revenues and control costs while retaining the value of universal service. We recognize this approach poses the difficult challenge of balancing commercial concerns and public service considerations, but it is possible to give the USPS the flexibility it needs while protecting the legitimate concerns of competitors, customers and the public at large. Many industrialized countries have successfully adopted post office models that combine commercial freedom, public ownership and a regulated monopoly. NALC urges the Congress to do the same.

Let me now turn to the main topic of this hearing, postal workforce issues. Our starting point is simple: Collective bargaining is a fundamental right of all workers, recognized under both international and domestic law. The National Labor Relations Act recognizes this right and, as a matter of national policy, encourages collective bargaining. The Postal Reorganization Act rightly established collective bargaining in the Postal Service under the auspices of the NLRA. Before addressing some principles for workforce reforms and a number of specific workforce issues, I'd like to make three general points.

First, I'd point out that collective bargaining in the Postal Service has been a resounding success. Since the Postal Reorganization Act was enacted, there has not been a single work stoppage or significant disruption in service as a result of labor relations. Given that the PRA was enacted in part as a result of a national postal strike in 1970, this 34-year record of peaceful labor relations should not be minimized.

In fact, postal collective bargaining has been a "win-win-win" proposition:

Postal workers have maintained decent pay and benefits resulting from the PRA – in stark contrast to the extremely low salaries that led to the strike in 1970;

Taxpayers have saved tens of billions of dollars as a result of the elimination of direct and indirect Treasury subsidies to the Postal Service; and

Postal Service customers have enjoyed stable postage rates that have generally increased in line with the overall rate of inflation over the course of the past three decades. (Indeed, taking postage costs and taxpayer costs together, the cost of mailing letters in America has fallen by more than a third in inflation-adjusted terms.)

All three groups – workers, taxpayers and mailers – have shared the fruits of major efficiency gains achieved over the past 30 years. The Bureau of Labor Statistics reports that postal labor productivity increased nearly 40 percent between 1972 and 2001 – a figure that does not account for the large reductions in the postal work force of the past two years. Postal collective bargaining has ensured that postal workers have shared in the benefits of these efficiency improvements. Congress can be proud that the existing collective bargaining system allows postal workers to enjoy middle class pay and benefits while maintaining the most affordable postage rates in the world and doing so without placing a burden on the American taxpayer.

Second, it is important to note that neither the postal unions nor postal management favor radical changes to existing postal collective bargaining system. We understand the unique nature of the USPS. We recognize that as an essential service that is vital to the national economy, the Postal Service is too important to the nation to allow disruptions. As a result we realize that any postal reform legislation will retain the existing prohibition against strikes and management lock-outs. A workable system for resolving collective bargaining impasses is therefore essential. NALC believes the existing system of interest arbitration has worked extremely well.

Third, it is important to note that postal labor relations have improved dramatically in recent years. All four unions have labor contracts in place that were voluntarily negotiated. All have made progress in reducing the number of work place grievances using various mechanisms. As the President' s Commission noted, my union's use of an alternative dispute resolution system is helping to transform workplace relations between the nation's letter carriers and their supervisors for the better. Since the Commission's report was issued, we have taken the next step to jointly identify problem work sites and to train labor-management intervention teams to propose practical solutions. These improvements occurred not because Congress or the GAO or any other outside party mandated them ; they happened because the parties themselves worked very hard to seek common ground and to find ways to resolve mutual problems. Postmaster General Jack Potter and his team deserve credit for working with us to achieve this transformation.

With these general points in mind, NALC urges you to abide by four principles when you consider reform of the collective bargaining system:

One, I urge you to follow the Hippocratic Oath: "First, do no harm." The system we have is not perfect – indeed, no system is perfect. But the parties have learned how to work together within the current framework and, as I outlined above, the process has worked well for all concerned. At a time of great change for the Postal Service in other areas, labor stability is crucial.

Two, maintain the flexibility that is built into the c urrent law. The PRA contains specific but flexible timetables for negotiating contracts and resolving collective bargaining impasses. It also provides a menu of options for impasse resolution and gives the parties the flexibility to shape these options for use when appropriate as conditions change. Indeed, the unions at this table have used at various times, mediation, fact finding, mediation-arbitration, mediation-fact finding in combination and last best offer arbitration. In the face of constant change, the flexibility of the current law is a virtue.

Three, avoid politicizing the collective bargaining process. Congressional or White House intervention in the process would be highly destructive. This would inevitably happen if a politically appoi nted regulatory body were injected into the negotiations process.

Four, avoid exposing the process to outside litigation. Subjecting the results of collective bargaining to litigation before a postal regulatory board, as proposed by the President's Commission, would be disastrous to the process. Depending on the prevailing political winds of the day and the makeup of the regulatory board at any particular moment, either side might be tempted to try to obtain from regulators what they could not expect to achieve through good faith bargaining.

Finally, I wish to address a couple of specific issues that have arisen in the wake of the report of the President's Commission on the USPS – the direct negotiation of pension and health benefits, and changes to the system of interest arbitration.

The Commission recommended that the administration study the feasibility of separate health and retirement plans for postal employees and that Congress consider making such benefit programs a direct subject of collective bargaining. I note that Senator Collins and Senator Carper have formally asked for such a study. Like you I await the results of that study with some interest. In the meantime, I'd like to share with you the NALC's perspective on these issues.

As you know, as employees of the federal government, postal employees are covered by either of the two federal pension plans, CSRS and FERS, and by the Federal Employees Health Benefit Program. Although eligibility for participation in these programs is automatic and is not subject to collective bargaining, it is important to understand that the cost of such benefits figure very prominently in postal labor negotiations. In the area of health benefits, postal management and its unions already directly negotiate the share of premiums to be paid by workers and the Postal Service. And when it comes to negotiating wage increases, the rising cost of pensions is explicitly discussed by the parties. The so-called roll-up factor for employee fringe benefits – the added cost of benefits when postal wages are increased – is never far from the negotiators' minds. And you can be sure that no interest arbitration panel employed over the past 20 years has been spared voluminous evidence from both sides on the cost of health and pension benefits.

My point is this: Although the parties do not directly negotiate over all aspects of postal benefit costs, these costs are not ignored and they invariably affect the results of wage negotiations. Indeed, a close examination of postal wage trends over the past 25 years reveals that postal wages have increased much less than wages in the private sector as measured by the Employment Cost Index. Since September 1975 when it was introduced the ECI for wages of private sector wages increased by 259 percent. Over the same period, postal bargaining unit wages increased 212 percent. I submit that this wage restraint is a direct reflection of the efforts of negotiators (and interest arbitrators) to restrain wage costs in the face of skyrocketing health and pension costs.

Given this context, we do not believe that is necessary to formally place health and pension programs on the collective bargaining table. The parties already effectively take these costs into account.

However, there are also practical reasons for rejecting separate postal-only benefit plans and/or direct negotiations.

Separating postal employees from CSRS, FERS and FEHBP would destabilize the programs for the rest of the federal workforce. The removal of postal employees from existing FEHBP plans, for example, would raise health care costs for other agencies and their employees since studies have shown postal employees to be healthier on average than other federal workers. Separate postal pension plans would add administrative costs for the Postal Service as it would have to create a new bureaucracy to run a postal-only plan that would inefficiently duplicate the existing system used by the Office of Personnel Management to disburse pension benefits.

Direct negotiation of benefit plans also raise the specter of introducing destructive inequities in pension and health benefit coverage both among postal employees – who are represented by four different unions – and between postal employees and other federal employees.

Let me turn to one other specific workforce topic raised by the President's Commission: Reforms to the postal interest arbitration process. The Commission suggested major changes to the existing dispute resolution process, including the elimination of tripartite arbitration, the imposition of a strict timetable for mediation and arbitration, the required use of "last best and final offer" procedures and regulatory review of collective bargaining agreements.

We believe these changes are unnecessary and counterproductive for a couple of very practical reasons. First, the Commission's proposals would discard 30 years of experience by the parties and require us to start all over again under a radically different process – a prospect that would inevitably impose significant costs on both sides. Second, we believe the only workable changes to the system of collective bargaining must be developed and negotiated by the parties themselves, not externally legislated or mandated. Both parties must see the process as "their process" for the results to be legitimate. The existing system gives us the flexibility to shape the dispute resolution process without outside intervention.

Let me add one last note on interest arbitration. We believe the existing dispute resolution system is a fair and acceptable alternative to the right to strike. I say this not because we always prevail when we go to interest arbitration. Indeed, on more than one occasion we have lost. In the 1990s an interest arbitration panel chaired by Richard Mittenthal adopted a USPS proposal to create a lower-paid temporary work force to handle the transition to full automation and another panel chaired by Rolf Valtin increased the employees' share of health insurance premiums. I say it because, win or lose, my members know that the existing system gives us a fair chance on the merits and therefore they accept the results as legitimate. The Commission's proposed changes in the area of interest arbitration fail this basic test of fairness. They would surely do more harm than good.

I want to conclude my testimony by repeating something I told the members of the President's Commission at its first public hearing in February 2003. Good labor relations must be built of trust and good faith between the parties. No amount of tinkering with the mechanics of the collective bargaining process will change that basic fact. At this moment of great challenges for the Postal Service, we have worked hard with the Postmaster General to build trust between us and to improve the workplace culture in the Postal Service. Please tread lightly in these areas so as not to risk the progress we've made.

I offer this Panel the full cooperation of the men and women who deliver the nation's mail everyday. Working together we can ensure that every American household and business will continue to enjoy the best postal service in the world for decades to come.

Mr. HOLTON. My name is Dale Holton, I am president of the 103,000 member National Rural Letter Carriers' Association. I too would like to thank the panel for the opportunity to be here to testify before you today.

Rural letter carriers deliver mail on 70,000 routes, drive 3 million miles a day, serve 32 million families and businesses. Our members are also known nationwide as a post office on wheels. The reason for that is we offer our customers all the services performed over the counter at a post office. We sell stamps, money orders, express and priority mail, delivery confirmation, certified or other accountable, and we accept parcels to be mailed. Rural letter carriers deliver on average 2,875 pieces of mail a day on each route. And this total includes approximately 200 parcels a week, a higher number than you would find on some city routes because of where we deliver. It is also because of the buying habits of our customers and the fact that, unlike our competitors, we have no surcharge for rural delivery.

The United States is unique in the world with regards to mail. We handle 46 percent of the world's mail. Americans do more financial transactions through the mail than any other nation in the world. Only 22 percent of Americans receive or pay any portion of their bills electronically. Yet, under current circumstances, the Postal Service business model will fail. There must be legislative changes to protect the U.S. Postal Service that Americans have come to count on and trust.

These opinions were confirmed by the poll conducted by the Presidential Commission. The antiquated rate-setting process needs to be revamped or replaced. Our competitor, electronic communication, goes around the world instantaneously. In order to remain competitive, the U.S. Postal Service needs the flexibility of being able to adjust rates as quickly as our competition. The "break-even" and "no retained earnings" provisions in the current business model that governs the Postal Service are years beyond their usefulness. Let us work with the business mail community and grow the U.S. mail volume with increased negotiated service agreements and intelligent mail.

The collective bargaining provisions of the current law have served their purpose well. As my colleagues said earlier, the U.S. Postal Service has had no labor disruption in over 30 years, unlike our counterparts in other nations. When bargaining becomes deadlocked, binding arbitration resolves the dispute. The current statute provides great flexibility for the bargaining parties to shape the process in a variety of ways. The Presidential Commission recommended mandating certain procedures rather than opting to utilize processes suited for the circumstances. We believe the flexibility of having options is vastly preferable. However, let me make one thing absolutely clear. Utilizing binding arbitration does not guarantee your side will prevail.

In our most recent bargaining, the Postal Service and the Rural Letter Carriers' went to binding arbitration. We tried the proposed route where we chose one arbitrator to go through the whole process with us and at the end, through binding arbitration, the Postal Service won and they won big. The average rural carrier lost 3.1 hours of productivity gains granted to the Postal Service per week.

That translated to an average loss for each carrier of $4,600 per year. It was offset only slightly by $2,600 in arbitrator-granted raises. The savings to the Postal Service, by their own figures, was approximately 12 million less paid hours annually due to this arbitration award. The award's savings to the Postal Service in rural carrier compensation amounts to $312 million annually.

I want to say that we appreciate the Presidential Commission's work and we welcome the active involvement of the White House and the Department of the Treasury. We believe their participation has expanded the interest in postal reform in Congress and in the mailing community. The National Rural Letter Carriers' Association has been at the forefront of attempts to enact meaningful postal reform legislation, and has publicly endorsed such legislation when it was introduced in the last three Congresses. We believe mail to be an important continuing government function. And one of the basic strengths of the U.S. Postal Service is our collection and delivery to everyone, everywhere, every day.

Chairman McHugh and Congressman Davis, we are today on a path toward enactment of postal reform legislation, primarily because of your Herculean efforts to update, educate, illuminate, and enact a new law for our mail community. You have our sincerest gratitude for your intellect and fortitude.

And this concludes my testimony, and I would be pleased to answer questions.

Mr. MCHUGH. Thank you very much, President Holton.

As they say, last but not least, John Hegarty, national president of the National Postal Mail Handlers Union. John, thanks for being here.

[The prepared statement of Mr. Holton follows:]

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Testimony of
Dale A. Holton, President
National Rural Letter Carriers' Association

before the

Committee on Government Reform's
Special Panel on Postal Reform and Oversight

February 5, 2004

I am Dale Holton, President of the 103,000 member National Rural Letter Carriers' Association (NRLCA). We deliver mail on 70,000 routes, drive 3 million miles a day and serve 32 million families and businesses. Our members are also known nationwide as a "post office on wheels" because we offer our customers all the services performed over the counter at a post office. We sell stamps and money orders, accept express & priority mail, signature and/or delivery confirmation, registered and certified mail, and, of course accept our customer's parcels.

Rural Letter Carriers deliver on average 2,875 pieces of mail a day on each route. This total includes approximately 200 parcels a week—a higher number than you would find on some city routes because of where we deliver, the buying habits of our customers and the fact that, unlike our competitors, we have no surcharge for rural delivery.

The United States is unique in the world with regards to mail. We handle 46% of the world's mail. Americans do more financial transactions through the mail than any other nation in the world. Only 22% of Americans receive or pay any portion of their bills electronically. Yet, under current circumstances, the Postal Service business model will fail.

There must be legislative changes to protect the United States Postal Service (USPS) that Americans have come to count on and trust. These opinions were confirmed by the poll conducted by the Presidential Commission. The antiquated rate setting process needs to be revamped or replaced. Our competitor, electronic communication, goes around the world instantaneously. In order to remain competitive the US Postal Service needs the flexibility of being able to adjust rates as quickly as our competition. The 'break-even" and "no retained earnings" provisions in the current business model that governs the Postal Service are years beyond their usefulness. Let us work with the business mail community and grow the US mail volume with increased negotiated service agreements and intelligent mail.

The collective bargaining provisions of the current law have served their purpose very well. USPS has had no labor disruptions in 30 years, unlike our counterparts in other nations. When bargaining becomes deadlocked binding arbitration resolves the dispute. The current statute provides great flexibility for the bargaining parties to shape the process in a variety of ways. The Presidential Commission recommended mandating certain procedures rather than opting to utilize processes suited for the circumstances. We believe the flexibility of having options is vastly preferable.

However, let me make one thing absolutely clear. Utilizing binding arbitration does not guarantee your side will prevail. In our most recent bargaining, USPS-NRLCA went to binding arbitration and the Postal Service won big. The average rural carrier lost 3.1 hours a week. That translates to an average loss for each carrier of $4600 per year, offset only slightly by $2600 in arbitrator granted raises. The savings to the Postal Service, by their own figures was

approximately 12 million less paid hours annually due to this arbitration award. The award's savings to USPS for rural carrier compensation is $312,000,000 annually.

We appreciate the Presidential Commission's work and welcome the active involvement of the White House and Department of the Treasury. We believe their participation has expanded the interest in postal reform in Congress and in the mailing community. The NRLCA has been at the forefront of attempts to enact meaningful postal reform legislation, and publicly endorsed such legislation when it was introduced in the last three Congresses. We believe mail to be an important continuing government function. And one of the basic strengths of the USPS is our collection and delivery to everyone, everywhere, everyday.

Chairman McHugh and Congressman Davis we are today on a path toward enactment of postal reform legislation. Primarily because of your Herculean efforts to update, educate, illuminate, and enact a new law for our mail community. You have our sincerest gratitude for your intellect and fortitude.
Mr. Chairman, this concludes my testimony. I would be pleased to answer any questions.

Mr. HEGARTY. Good afternoon, and thank you Chairman McHugh and members of the committee for this opportunity to testify. My name is John Hegarty and I am the president of the National Postal Mail Handlers Union, which serves as the exclusive bargaining representative for 57,000 mail handlers nationwide.

The Mail Handlers Union hopes to remain an active participant in the process of postal reform. The recently released White House principles show that the White House has considerable confidence in the expertise and legislative initiative——

[Public announcement interruption.]

Mr. HEGARTY. Let me continue. The recently released White House principles show that the White House has considerable confidence in the expertise and legislative initiative of your committee and that of your Senate counterparts. I would like to congratulate you, Chairman McHugh and Representatives Danny Davis, Henry Waxman, and Tom Davis, and all others who have provided leadership on this issue.

I would like to take a few moments to comment on the last terrorist act against homeland security affecting both Congress and the U.S. Postal Service, and of course I am talking about the poison ricin, which was found in Senator Frist's mailroom on Monday. A similar powder spill incident in Wallingford, CT, has thankfully tested out negative for both ricin and anthrax.

It is perhaps ironic that the ricin incident occurred on the evening before we were scheduled to testify before the Senate Committee on Governmental Affairs on the future of the Postal Service and its employees. The advance NPMHU written testimony raised the danger of substances such as anthrax and ricin and noted why mail handlers are so crucial to the safety and security of our country. That hearing obviously has been postponed as the need for safety and security goes on.

As a mail handler from a large processing plant in Springfield, MA, let me briefly explain how these types of terrorist threats could attack mail handlers and indeed all craft employees. Mail handlers are generally the first to handle mail when it enters a processing plant. Raw or unprocessed mail, which could be letter-sized envelopes or larger, flat-sized envelopes, packages, or parcels are dumped, typically on a conveyer belt-type of a system and worked—or culled and sorted—by mail handlers. Letters and flats are run through a cancellation machine to cancel the stamps and are then forwarded to other mail processing machinery throughout the building which is typically manned by either mail handlers or clerks. After all the processing is completed, mail handlers load the processed mail onto outbound transportation. As you can see, this is a labor-intensive, hands-on type of mail processing. Mail handlers and all craft employees therefore are on the front lines when it comes to possible exposure to biological agents or other terrorist threats through the mail.

As always, the safety of mail handlers and other postal employees is the first concern of the National Postal Mail Handlers Union. We are working with the Postal Service through the Task Force on Mail Security on these dangerous incidents. We appreciate the funding that Congress has already appropriated for bio-protection

systems to keep our employees safe and we look forward to working with Congress on those issues in the future.

The Mail Handlers Union appreciates the swiftness of your reaction to the CSRS funding problems and the financial strain caused by the deadly anthrax attacks. Similar financial issues remain, however, and congressional resolution of both the escrow issue and the military service issue are of immediate and paramount importance to the financial future of the Postal Service. Not releasing the postal escrow account or forcing the Postal Service to pick up more than $27 billion in military costs that no other Federal agency has to pay certainly will result in a severe crisis in the Postal Service and, ultimately, a hike in postage and cost to all ratepayers.

As I noted, the White House provided broad guidelines in terms of postal reform. We believe the Postal Service needs the tools to be more competitive. In accordance with those guidelines, those tools could include price flexibility and a ratemaking structure that, as the White House indicated, is more similar to generally accepted business models. For example, we are experiencing yet another spike in fuel costs and, once again, the Postal Service is not structurally set up to respond quickly to the problem. It is difficult to run in a businesslike fashion when common business practices are not an available option.

My union, therefore, counts itself in strong support of legislative change that would grant the Postal Service additional flexibility in pricing, additional flexibility in borrowing and the design of postal products. Such changes must allow the Postal Service to establish postal rates that remain affordable, both to the major business mailers and the American consumer, while providing sufficient revenue to protect and support the infrastructure that universal service requires and to provide postal employees with a decent and fair standard of living.

I do have considerable expertise in the area of the President's Commission in work force issues. I believe that the term "best practices" can be applied to the Postal Service's labor relations. In general our collective bargaining process is seen by others as a model of flexibility and labor peace. In recent years, moreover, all parties have been working on these matters diligently and our efforts have resulted in dramatic changes.

The Mail Handlers Union strongly endorses the current process for collective bargaining under the Postal Reorganization Act. Our current national agreement covers the period from November 2000 through November 2006. Although it originally was scheduled to terminate later this year, we recently reached an agreement on a 2-year extension to the contract that was overwhelmingly ratified by our members. Nor is productive collective bargaining a recent phenomenon.

Since the PRA was enacted in 1970, we have engaged in 13 rounds of full collective bargaining with the Postal Service, 8 of which, including the last 3, have resulted in voluntary agreements that were endorsed by postal management and ratified by the union membership. The other five were resolved through arbitration with the results willingly accepted by both parties. On at least three of the five occasions when the parties used arbitration, however, the parties actually settled most open issues and only arbi-

trated one or two issues that could not be resolved without an arbitrator's decision. Even when arbitration does occur, there are no guarantees. For example, arbitration in the 1984 round of bargaining created a lower entry rate for new mail handlers, and an arbitration in the 1990 round produced a 3-year contract without any general wage increases for mail handlers. Because both parties accept the process, however, even these clear management victories were implemented peacefully.

The key advantage of the current bargaining process is its flexibility, which coincidentally is one of the administration's principles. Under the current statute, the parties to any bargaining dispute are allowed to devise their own procedural system for resolving their dispute. Thus, under the PRA fact-finding followed by arbitration is the default position, but the parties in prior years have used fact-finding, mediation, arbitration, and multiple combinations of these processes to resolve their disputes. If the procedural changes recommended by the Presidential Commission were adopted, this flexibility would be eliminated and instead the parties would be constrained by rigid procedures that, in our view, would not improve the bargaining process one iota.

The Commission said that a core ingredient of its revised procedure is the mediation-arbitration approach to resolving bargaining impasses. Under a "med-arb" approach, the fact-finding phase now set forth in the PRA would be replaced with a mandatory mediation phase of 30 days, and if mediation were unsuccessful, the appointed mediator would become one of the final arbitrators. We believe, however, that requiring this "med-arb" approach would be counter-productive to the successful resolution of many bargaining disputes. The flexibility now part and parcel of the PRA permits the use of "med-arb" and it has been utilized in prior rounds of bargaining when the parties deemed it advisable.

Also, part of the President's Commission recommendation is a proposal that would replace the parties' current practice, which uses a three-member arbitration panel, in which each party chooses one arbitrator and then the parties jointly select one neutral arbitrator, with three outside arbitrators. In our view this change would have extremely negative consequence for the arbitration process, as it would completely remove the parties' respective representatives and their unique expertise from the decisionmaking process.

The Commission also has recommended that after the arbitration decision is issued the parties have 10 days to review the decision and possibly bargain changes agreeable to both union and management. This proposal would be completely unnecessary if the current process allowing for each party to have a representative involved in the arbitration decision were made or maintained. It also poses problems for most unions, like the mail handlers, that require membership ratification for any bargaining agreement.

The Commission has also recommended that binding arbitration be required to use the "last best final offer" model, in which each party is required to submit a total package of proposals and the arbitration panel is required to choose one or the other package and cannot compromise between the two. In theory, this would place extraordinary pressures on both sides to produce reasonable com-

prises. Sometimes this model of arbitration would be helpful, but other rounds of bargaining would not be helped by requiring "last best final offers." The current statute allows for "last best final offer," and it has been used in certain bargaining. The flexibility built into the current system is essential and should be maintained.

Frankly, I believe the Nation is better off with bargaining and binding interest arbitration under the PRA than with those other models. The testimony before the Presidential Commission from postal management and the postal unions and even from a panel of highly respected neutral arbitrators was consistent: that the current collective bargaining process is working well. For 33 years the parties have avoided labor strife and economic warfare that often characterize private sector labor-management relations. Arbitrators and participants all agree that the process has improved dramatically over the years and may be a model for other labor-management negotiations. There is, in short, no reason whatsoever to amend the statutory provisions governing collective bargaining or to otherwise adopt provisions that would allow outside entities to interfere in the bargaining process.

The Presidential Commission also has proposed bargaining over health insurance, pensions and other benefit programs. In fact, the current employee contribution rates for health insurance already are bargained, and the health benefits themselves established through the Federal Employees Health Benefit Act are universally acknowledged to be well maintained and well negotiated by the Office of Personal Management. The Mail Handlers Union happens to be the sponsor of one of the largest Federal health plans, and I can assure you that if the Postal Service ever were to withdraw from the Federal employees health system, chaos would be the result. As for pension benefits, with the passage last year of the "CSRS fix" legislation, all pension benefits for postal employees are now fully funded. The recommendation on bargaining benefits, therefore, is clearly aimed at guaranteed health insurance for postal retirees. We see absolutely no reason why promises of lifetime health insurance to postal employees should be the subject of bargaining, especially when the Federal Government provides these benefits to Federal employees through legislation and many other large employers provide similar benefits. In any event, recent proposals from postal management would allow the Postal Service to ensure funding of these retiree health costs by using the escrow account now available because of pension over-funding. That is an appropriate use for those funds and should be part of any postal reform.

Thank you for allowing me to testify and I would be happy to answer any questions.

[The prepared statement of Mr. Hegarty follows:]

National Postal Mail Handlers Union

John F. Hegarty
National President

Mark A. Gardner
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TESTIMONY OF

JOHN F. HEGARTY
NATIONAL PRESIDENT
NATIONAL POSTAL MAIL HANDLERS UNION

BEFORE THE

SPECIAL PANEL ON POSTAL REFORM
AND OVERSIGHT
OF THE
HOUSE GOVERNMENT REFORM COMMITTEE

FEBRUARY 5, 2004
CHICAGO, ILLINOIS

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Good afternoon, and thank you, Chairman McHugh, and members of the Committee, for this opportunity to testify. My name is John Hegarty, and I am National President of the National Postal Mail Handlers Union (NPMHU), which serves as the exclusive bargaining representative for approximately 57,000 mail handlers employed by the U.S. Postal Service.

The NPMHU appreciates this opportunity to remain an active participant in the process of postal reform. The recently-released White House principles provide us with additional proof of just how far the Committee has come in the past eight years of wrestling with postal reform. I would like to congratulate you, Chairman McHugh, and Representatives Danny Davis, Henry Waxman, and Tom Davis, and others who have provided leadership on this issue.

The NPMHU also appreciates the swiftness of your reaction to the CSRS funding problem and the financial strain caused by the deadly anthrax attacks. Similar financial issues remain, however, and Congressional resolution of both the escrow issue and the military service issue are of immediate and paramount importance to the financial future of the Postal Service. Conversely, not releasing the postal escrow account or forcing the Postal Service to pick up more than $27 billion in military costs that no other Federal agency or department has to pay certainly will result in a severe crisis to the Postal Service and, ultimately, a hike in the cost of postage to all ratepayers, including not only major mailers but also the average American consumer. We are prepared to do whatever it takes to get both of these matters resolved swiftly.

As noted, the White House provided broad guidelines in terms of postal reform. At bottom, the release of these principles show that the White House has considerable confidence in the expertise and legislative initiative of your Committee and that of your Senate counterparts. Although the NPMHU has taken no formal position on some of the White House principles, such as greater transparency in finances, we do believe that the Postal Service needs the tools to be more competitive. Those tools include price flexibility and a ratemaking structure that, as the White House indicated, is more similar to generally accepted business models. For example, we are experiencing yet another spike in fuel costs and, once again, the Postal Service is not structurally set up to respond quickly to the problem. It is difficult to run in a businesslike fashion when common business practices are not an available option.

Although I do not claim to be an expert in business models, I do have considerable expertise in the area that the President's Commission called workforce issues. I started my postal career as a mail handler in 1984, and I have served as a Union and mail handler representative for much of the past twenty years.

The major concerns of the NPMHU revolve around the workforce recommendations that found their way into the Commission's report, and specifically many of the recommendations directly related to collective bargaining. Although these issues were not specifically addressed in the White House principles, I truly believe that the term "best practices" can be applied to Postal Service labor relations. In general, our collective bargaining process is

seen by others as a model of flexibility and labor peace. Moreover, I believe that, in recent years, labor-management relations in the Postal Service have evolved. All parties have been working on these matters diligently, and our efforts have resulted in some dramatic progress, as I will discuss shortly.

* * *

Mail handlers are an essential part of the mail processing and distribution network utilized by the Postal Service to move more than 200 billion pieces of mail each year. We work in all of the nation's large postal plants, where mail handlers are responsible for loading and unloading trucks, transporting mail within the facility (both manually and with powered industrial equipment), preparing the mail for distribution and delivery, operating a host of machinery and automated equipment, and sorting and containerizing mail for subsequent delivery. Our members generally are the first and the last employees to handle the mail as it comes to, goes through, and leaves most postal plants.

The majority of mail handlers are employed in large postal installations, including several hundred Processing & Distribution Centers, Bulk Mail Centers, Air Mail Centers, and Priority Mail Processing Centers. The largest of these installations, most often measured as those which utilize 200 or more bargaining unit employees, currently employ more than 90% of the mail handlers represented by the NPMHU, and close to 80% of mail handlers work in installations that have 500 or more postal employees.

Although mail handlers are located throughout the United States, they are not spread evenly across all geographic areas. For example, more than

40% of all mail handlers are employed in seven of the largest Consolidated Metropolitan Statistical Areas that are tracked by the Census Bureau—i.e., New York, Chicago, Washington-Baltimore, Los Angeles, San Francisco, Philadelphia, and Boston. And thousands of other mail handlers are working in or near other large cities, including Buffalo, Cincinnati, Cleveland, Dallas, Denver, Detroit, Hartford, Houston, Indianapolis, Milwaukee, Pittsburgh, Providence, Richmond, St. Louis, Minneapolis-St. Paul, Phoenix, Seattle, and Springfield, Massachusetts. The vast majority of mail handlers, therefore, work in the nation's twenty-five largest metropolitan areas, where the cost of living is generally higher than average.

Virtually all newly-hired mail handlers are employed in part-time flexible positions, with no fixed schedule, and no guaranteed work beyond two or four hours (depending on the size of the facility) per two-week pay period. For this position, the current starting pay – as of November 2003 – is $13.92 per hour (or only $13.38 if the position is full-time). Even assuming that such a recently-hired mail handler is assigned work for 40 hours per week, at that hourly rate a new mail handler would earn base annual wages equal to only $28,953 per year (calculated as $13.92 per hour for 2,080 hours). Assuming that the mail handler continues to work for the Postal Service, after several years of part-time employment, the employee generally (although not always) would be converted to a full-time regular position with fixed days and hours. This fixed schedule usually includes work at night between the hours of 6:00 pm and 6:00 am (over half of all mail handler hours fall within this time frame) and often includes work on weekends. After thirteen years of working for the

Postal Service, the wage scale currently in effect provides for a mail handler hourly wage of $20.12 per hour. This base wage remains the same, subject to future negotiated increases, for the remainder of the mail handler's career, such that a mail handler who has dedicated 30 years or more of his or her life to the Postal Service also currently earns that same amount -- $20.12 per hour or $41,849 per year.

We believe the current wage system is fair, but it certainly is not an extravagant amount to pay for a workforce dedicated to the Postal Service and the American public. We dare say that no one complaining about the level of postal wages—nor one of their hired lawyers, paralegals, or even secretaries – earns less than this amount after thirty years of dedicated service. Nor is an entry wage of less than $14.00 per hour for a part-time job without guaranteed hours unreasonably high. To the contrary, the NPMHU submits that the Postal Service easily could justify the payment of higher wages to its career employees.

* * *

The NPMHU counts itself as a strong supporter of legislative change that would grant the Postal Service additional flexibility in pricing, borrowing, and the design of postal products.

We recognize that the Postal Service must change with the times. But it must do so in a way that preserves the core mission of the Postal Service. Congress has the chance to provide the Postal Service with additional flexibility in the setting of prices, the freedom to design or introduce new postal products, and the ability to borrow and invest with fewer constraints, and taken together

such reforms can help the Postal Service survive – if not thrive – well into the 21st Century. To do so, legislative change must ensure that the Postal Service is allowed to establish postal rates that remain affordable, both to the major business mailers and the average American consumer. At the same time, those rates also must be sufficient to protect and support the infrastructure that universal service requires, and to provide postal employees with a decent and fair standard of living. Although much work remains to be done, the NPMHU plans to remain a part of the upcoming legislative process necessary to enact these statutory changes. There is a sense of optimism that appropriate reform of the Postal Reorganization Act could ensure a successful Postal Service for decades into the future.

* * *

The NPMHU strongly endorses the current process for collective bargaining under the Postal Reorganization Act, including initial face-to-face negotiations, followed by possible mediation or other dispute resolution procedures agreed to by the parties, and culminating, if necessary, in binding interest arbitration before an independent and neutral, but jointly selected, arbitrator.

The current National Agreement between the NPMHU and the Postal Service covers the period from November 2000 through November 2006. Although it originally was scheduled to terminate later this year, the NPMHU recently reached an agreement with the Postal Service on a two-year extension to the contract that was overwhelmingly ratified by our members. There is every reason to believe, moreover, that the positive bargaining relationship

between the NPMHU and postal management will remain relatively stable into the foreseeable future.

Nor is labor peace a recent phenomenon. Since the PRA was enacted in 1970, the NPMHU and the Postal Service have engaged in thirteen rounds of full collective bargaining, eight of which (including the last three, in 1998, 2000, and 2003) have resulted in voluntary agreements that were endorsed by postal management and ratified by the union membership. The other five were resolved through arbitration, with the results willingly accepted by both parties. Moreover, on at least three of the five occasions when the parties reached impasse and resolved their negotiations dispute through arbitration, the parties actually settled most open issues, and arbitrated only one or two issues that could not be resolved without an arbitrator's decision. Even when arbitration does occur, there are no guarantees. Arbitration in the 1984 round of bargaining created a lower entry rate for new mail handlers, and arbitration in the 1990 round produced three years without any general wage increases for mail handlers. Because both parties accept the process, however, even these clear management victories were implemented peacefully.

The key advantage of the current bargaining process is its flexibility. Under the current statute, the parties to any bargaining dispute are allowed to devise their own procedural system for resolving their dispute. Thus, under the PRA, factfinding followed by arbitration is the default position, but the parties in prior years have used factfinding, mediation, arbitration, and multiple combinations of these processes to resolve their disputes. If the procedural changes recommended by the Presidential Commission were

adopted, however, this flexibility would be eliminated, and instead the parties would be constrained by rigid procedural rules that, in the NPMHU's view, would not improve the bargaining process one iota.

In contrast to the current flexibility, for example, the Commission stated that the "core ingredient" of its revised procedure for bargaining is to use a mandatory, meditation-arbitration or "med-arb" approach to resolve bargaining impasses. Under a med-arb approach, the factfinding phase now set forth in the Postal Reorganization Act would be eliminated and replaced with a mandatory mediation phase of thirty days, and if the mediation were unsuccessful, the appointed mediator would become one of the final arbitrators. The NPMHU, however, believes that requiring this med-arb approach would be counterproductive to the successful resolution of many bargaining disputes. (It bears noting, of course, that the flexibility now part and parcel of the PRA permits the use of med-arb, and it has been utilized in prior rounds of bargaining when the parties deemed it advisable.) Simply put, it would corrupt any attempts at mediation, by destroying the usual confidentiality of the mediation process, and making it impossible for either party actually to share its priorities with the appointed mediator. To quote a noted expert, "parties to a combined mediation-arbitration procedure are often reluctant to retreat from extreme positions or to reveal how they prioritize their interests. [This] reduces [the] likelihood of bringing about agreement. It also reduces the likelihood that the arbitrator will have an accurate view of the parties' priorities."

Also part of the Presidential Commission's recommendation is a proposal that would replace the parties' current practice – which uses a three-member arbitration panel, in which each party chooses one arbitrator and then the parties jointly select one neutral arbitrator – with three professional arbitrators. In our view, this change would have extremely negative consequences for the arbitration process, as it would completely remove the parties' respective representatives and their unique expertise from the arbitral decision-making process. It makes it much more likely that the eventual arbitration decision will be contrary to the desires of either or both parties. It also severely reduces the likelihood that the parties might be able to mediate and settle (or narrow) their dispute during the arbitration process.

The Commission also has recommended that, after the arbitration decision is issued, the parties have ten days to review the decision and possibly bargain changes agreeable to both union and management. This proposal would be completely unnecessary if the current process allowing for each party to have a representative involved in the arbitration decision-making were maintained. It also poses problems for most unions, such as the NPMHU, that require membership ratification after any bargained agreement.

The Commission also has recommended that the binding interest arbitration be required to use the "last best final offer" model, in which each party is required to submit a total package of proposals, and the arbitration panel is required to choose one or the other package, and cannot compromise between the two. In theory, this would place extraordinary pressure on both sides to produce reasonable, workable compromises that incorporate the

interests and priorities of both parties. Sometimes this model of arbitration would be helpful, but other rounds of bargaining would not be helped by requiring last best final offers. The current statutory model allows for last best final offer, and in fact it has been used in certain rounds of bargaining. But making such a system mandatory, through legislative change, would not be helpful, as it would remove the flexibility from the current system, which specifically allows the parties to use the last best final offer or any other process that they mutually believe would help to resolve the bargaining dispute.

At bottom, no one involved in the bargaining process, including the Postal Service itself, has ever offered a convincing reason for amending the current statutory language into a set of locked-in, inflexible procedures that are certain to displease one or both parties at some point in the future. The current provisions, which grant flexibility to the parties to determine, in each round of bargaining, what procedures should be followed to best settle their dispute, should be maintained. An unjustified change in the statutory language is not reform; it simply is an unjustified change.

I understand that the history of bargaining that I have described is not noteworthy of news coverage. It certainly would be more exciting if postal employees were covered by the National Labor Relations Act, like UPS employees, so that they could strike at each impasse in negotiations, or if postal employees were covered by the Railway Labor Act, like airline or railroad employees, so that Congress could be asked to intervene in labor disputes. Frankly, I believe the nation is better off with bargaining and binding interest

arbitration under the PRA than with those other models. Remember, when UPS suffered a total shutdown for several weeks in 1997, it was the Postal Service and its employees who willingly took on the monumental task of processing and delivering millions of additional packages during that UPS strike to ensure that the American economy was not damaged. I assure you that UPS could not substitute for the Postal Service if postal employees ever were to engage in a work stoppage.

My description of postal collective bargaining also has the advantage of being true and accurate. To be sure, the actual facts and history of postal collective bargaining contradict the rhetoric that often emanates from so-called postal commentators and critics. Remember, none of those commentators ever has sat at the negotiating table or otherwise engaged in collective bargaining in the Postal Service. Their real complaint – if they even had a complaint – is with the results of collective bargaining, not with the process.

Our current contract or National Agreement provides mail handlers with semi-annual cost-of-living adjustments (COLAs) that guarantee small wage improvements approximating 60% of the increase in the Consumer Price Index. The existence of this COLA provision means that employees receive relatively small general wage increases. In the aggregate, wage increases in the Postal Service are non-inflationary. Since enactment of the PRA in 1970, postal wage increases have been less than the rate of inflation measured by the Consumer Price Index, and less than salary improvements granted by the federal government or by large employers in the private sector. For example, as of next month, when the next COLA payment is calculated, postal employees this year

will receive a wage increase of less than 2.5%, whereas federal employees are expected to receive 4.1%, and private-sector bargaining agreements are now averaging above 3%.

Many also ask about the relationship of wages to productivity. During the past three decades, the productivity of mail handlers and other postal employees has increased dramatically, including notable increases in productivity during the past year. The Postal Service today processes and delivers more than 200 billion pieces of mail using approximately 725,000 employees. Not too many years ago, approximately the same number of employees was used to process and deliver one-half as much mail. Through a combination of automation, improved mail flow, and other means, today's mail handlers and other postal employees are more productive than ever before. Indeed, the Postal Service recently reported that 2004 will mark a record fifth straight year of positive productivity growth.

There was consistent testimony before the Presidential Commission – from postal management, from the NPMHU and other postal unions, and even from a panel of highly-respected, neutral arbitrators – that the current collective bargaining process is working well. For thirty-three years, the parties have successfully used the current statutory process and avoided the labor strife and economic warfare that often characterizes private-sector labor-management relations. Arbitrators and participants all agree that the process has improved dramatically over the years, and may be a model for other labor-management negotiations. There is, in short, no reason whatsoever to amend the statutory provisions governing collective bargaining, or to otherwise adopt

provisions that would allow outside entities to interfere in the bargaining process.

The NPMHU also strongly opposes calls for increased privatization that might be aimed at mail handlers or other postal employees. Privatization as a means of eliminating hundreds of thousands of career postal employees is more a political ploy than a practical solution. Even more pernicious, however, can be proposals to privatize smaller parts of the Postal Service through increasing the subcontracting of traditional postal work to private contractors. If countenanced, such subcontracting could mean that the Postal Service would lose the services of dedicated career employees at precisely the wrong time in our nation's history. Not only do postal employees have a special understanding about how to process mail efficiently and effectively, but in recent years they have been especially adept at dealing with issues related to mail security, and working to protect the American public against anthrax attacks, mail bombs, or other hazardous materials or similar threats of terrorism that might, and sometimes actually do, find their way into the U.S. mail. The American public and Congress finally have recognized that only federal civil servants, and not low-paid and untrained subcontracted employees, are capable of protecting our nation's airports and border crossings. The nation needs similar homeland security for its mail. As with airport security, a dedicated workforce of professional postal employees is the best defense against those who would use the mail to harm our national security.

It bears noting, moreover, that many examples of recent subcontracting by the Postal Service have been colossal failures. Approximately five years ago,

for example, the Postal Service decided to contract with Emery Worldwide Airlines to process Priority Mail at a network of ten mail facilities along the Eastern seaboard. Today, the work at those facilities finally has been returned to mail handlers and other career employees, but not before the Postal Service suffered losses in the hundreds of millions of dollars. At a recent meeting of the USPS Board of Governors, one Governor said publicly that the Emery subcontract was one of the worst decisions that the BOG ever had made.

A similar story can be told about outsourcing of the Mail Transportation and Equipment Centers, or MTECs. Several years ago, about 400 mail handlers were displaced from these facilities, in favor of private-sector employees working for contractors who passed their costs on to the Postal Service. The Office of Inspector General has audited these contracts, and has concluded, once again, that the Postal Service has wasted tens of millions of dollars in the inefficient use of these contractors, and that the same work, if kept inside the Postal Service, would have been performed more cheaply. Congress should not follow the Presidential Commission's suggestion to encourage similar errors with additional subcontracting.

The Presidential Commission also has proposed that the PRA be changed to require the postal unions and the Postal Service to bargain over health insurance, pensions, and other benefit programs. In fact, the current employee-contribution rates for health insurance already are bargained, and the health benefits themselves – established through the Federal Employees Health Benefit Act – are universally acknowledged to be well maintained and well negotiated by the Office of Personnel Management. The NPMHU happens

to be the sponsor of one of the largest federal health plans, and I can assure you that if the Postal Service ever were to withdraw from the federal employees health system, chaos would be the result. As for pension benefits, with the passage last year of the CSRS-fix legislation, all pension benefits for postal employees are now fully funded. The Commission's recommendation on bargaining benefits, therefore, is clearly aimed at guaranteed health insurance for postal retirees. The NPMHU sees absolutely no reason why promises of lifetime health insurance to postal employees should be subject to collective bargaining, especially when the federal government provides these benefits to federal employees through legislation, and many other large employers provide similar benefits. In any event, recent proposals from postal management would allow the Postal Service to ensure funding of these retiree health costs by using the escrow account now available because of pension overfunding. That is an appropriate use for those funds, and should be part of any postal reform.

* * *

Finally, I would be remiss if I did not address the Presidential Commission's attempt to analyze labor-management relations by looking at the number of pending grievances. For many years, the parties – both during collective bargaining and while contracts have been in effect – have worked strenuously to adjust the grievance process to ensure more timely and less costly dispute resolution. Most notably, a few years ago the NPMHU and the Postal Service agreed to produce a Contract Interpretation Manual or CIM that would set forth the parties' joint interpretation on literally thousands of

contract issues, and I am extremely pleased to report that, last year, the CIM was finally published. This 300-page manual, as promised, is a compendium of the parties' joint understanding on the meaning of their contract. Between July and October 2003, we jointly trained more than one thousand union and management representatives, from virtually every large postal installation that employs mail handlers, on how to use the CIM to resolve disputes without the need to file a grievance or proceed to arbitration. Early results are extremely encouraging, as the parties' local representatives work diligently to settle their pending disputes and to prevent future disagreements. This is just one model for how the parties are able to resolve their own problems, without legislative interference.

* * *

Finally, let me emphatically state the NPMHU's support for the positions recently stated by Postmaster General Potter with regard to the two financial issues that remain from last year's Civil Service Retirement System legislation. First, the NPMHU urges Congress to shift from the Postal Service, back to the Treasury Department, the retirement liability costs of postal employees whose military service occurred before they became postal employees. Continuing to impose this obligation on the Postal Service would transfer payment of more than $27 billion from American taxpayers to postal ratepayers, and we see no justification for such a transfer. Second, the Postal Service should be freed of the financial constraints included in the CSRS legislation, which requires the Postal Service to put CSRS savings beginning in fiscal year 2006 into escrow pending congressional review. This requirement, if allowed to continue, would

negate the benefits that the CSRS legislation made possible, and would unjustifiably impose higher than necessary rate increases on the Postal Service and its customers. As the representative of employees who desire a strong and successful Postal Service, the NPMHU sees no justification for continuing this escrow arrangement.

* * *

Thank you for allowing me to testify. I would be glad to answer any questions you may have.

Mr. MCHUGH. Thank you very much, President Hegarty.

Gentlemen, as I have said, we deeply appreciate you being here today. This is, as Yogi Berra said, "deja vu all over again" for many of us. We have had private meetings, we have had previous hearings that your organizations have been represented at, and I do not want to beat the proverbial dead horse. Also, I would add that your statements are very, very comprehensive in your analysis of the challenges, your analysis of particularly, as we asked you to do, the President's Commission recommendations and findings.

What I would like to hear, because Congress sometimes has trouble walking and chewing gum at the same time. We cannot have too many balls in the air, and while I do not for a moment minimize the incredible breadth——

[Public announcement interruption.]

Mr. MCHUGH. But in any event we have an excellent profile of the concerns of the issues that you deem important, but if you had to individually name for us the one or two issues that you feel a postal reform bill must include, in other words, without those particular components, it is useless, what do you tell us would have to be in such a bill? And I will start with Bill Burrus.

Mr. BURRUS. I think it is absolutely essential in addressing the future needs of the Postal Service, if reform means putting the Postal Service in a position, financial position to provide universal service to the American public far into the future, I think the absolutely essential issues that must be resolved are those that sap the financial resources of the Postal Service. During my testimony I listed three that add up to some $123 billion of cost to be imposed on the Postal Service. I am not aware of any other modification that is under consideration or that is on the radar screen within the realm of possibility that would generate one fifth of that obligation that is being imposed upon the Postal Service, through the escrow and the CSRS and the prior Federal service. And on top of that is the interest in requiring that the Postal Service fund their health care for their retirees. If you add that on top of the $120 billion, you are talking about now almost $180 billion of financial obligation of the Postal Service during a period where there are those who say the Postal Service is in a death spiral, it will be ill-equipped to fund.

So, I do not know of any other—we went through a period in the 1980's where reform of the Postal Service was changing the logo; we reinvented the postal logo, changed the colors of the Postal Service, did the mail boxes and all the trucks under the umbrella of reform. I think fundamental to the Postal Service and its ability to exist in the future is money and almost $200 billion in costs. If you do flexible rate setting, it is not going to generate $200 billion. If you permit us to compete with UPS and FedEx, compete in other markets out there, there is no possibility you are going to get anywhere near $200 billion.

So, if I were to select a single issue I think stands alone, I do not think there is even a close second that one has to address the three main issues and somehow address the health care for retirees, because it is going to continue to surface over the years. So that $200 billion has to be addressed. I think anything else while

we are seeking and achieving reform, I think we are whistling into the wind.

Mr. MCHUGH. Thank you, sir. President Young.

Mr. YOUNG. From my perspective the most important element is the perseverance of universal service. That to me is the linchpin of the whole organization. If we do not have that, I think everything else tumbles behind it.

The second most important thing to me would be to work on the business model. Thirty years ago, when the Postal Reorganization Act was enacted, we did not have computers, e-mails and things like that were just distant dreams. We have to change the structure of the way the Postal Service is allowed to operate so that they can be competitive in the Internet age.

So those are my two issues, and I think those are the essential points. Of course, I am very concerned about collective bargaining, but that would be a definite element of the second issue that I raised. But the key one, the most important one above all, is perseverance of universal service.

Mr. MCHUGH. Thank you, sir.

Mr. HOLTON. And I agree wholly with the universal service at an affordable price for everybody, but in order to maintain that I also believe that you have to do something with the business model in the form of pricing flexibility to allow the Postal Service to have a little bit better way of trying to establish prices as they need to, rather than waiting 18 months after they determine they need a rate increase. And then 18 months later, they finally get it, only to find out that fuel costs have gone up and other expenses have gone up to where now they have to ask for another one. So I would say universal service and improving the model through pricing flexibility are the main things at an affordable cost.

Mr. MCHUGH. Thank you, sir. Mr. Hegarty.

Mr. HEGARTY. I agree with my colleagues. I also feel the escrow account and the military retirement money is very important to the survival of the Postal Service. But I would also like to say one thing that should not be done through postal reform, and that is to change the collective bargaining along the lines of what the Presidential Commission is recommending. And I am sure you have seen it in all of our testimony.

You have 750,000 dedicated career craft employees, management employees, we work weekends, we work nights, we work 24 hours a day, 7 days a week. And I think cutting postal employees' pay and benefits or subjecting our current collective bargaining system to the draconian changes that have been recommended, could have a drastic effect on the morale and wellbeing of all of our employees. And I think that is the essence of the organization—the dedication of these front line employees that do the work day in and day out.

Mr. MCHUGH. Thank you, gentlemen. Mr. Davis.

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

Gentlemen, let me thank you for your testimony. Oftentimes, when we talk about finding economies of scale and when we talk about finding the most efficient and effective way of providing a service or producing a product, we hear about downsizing, outsourcing and privatizing, especially as that has been related to anything connected with government. What impact do you think

these concepts would have on restructuring the Postal Service and on the memberships that you represent?

Mr. BURRUS. I have enjoyed a 50-year career as a postal employee and throughout that period the Postal Service has always been in a period of flux of people. There is no real security in postal jobs except against layoff. Employees currently in the city of Chicago, some 200, 300 or 400 employees are facing the possibility of being reassigned outside of their work location, the office in which they have spent all of their working lives. So that is a part of postal employment. It is something we do not like but it is part of postal employment. We have attached that protection against layoff, but within those very broad parameters, employees are reassigned from post to post.

In this discussion of reform the Commission made the recommendation of applying an economic model to rural post offices. If they were not self sufficient, there would be authority to close them, based upon economic issues. Plus, applying a BRAC model to the consolidation of plants. As a service agency, I think that the Postal Service's fundamental obligation is to the American public and that on occasion it is at odds with making a profit in a specific location. So for the job protection of the employees and for the continuation of universal service at universal cost to all Americans, we believe there should be some stability; in those very broad parameters, there has to be some stability.

Now we are entering an age in our society where workers' changing jobs 20, 30, 40 times is expected during their working life. I guess you could apply that to postal employees where they are not really changing jobs, they are just changing work locations, but individually it causes a lot of unrest, and a lot of uncertainty, and a lot dislocation for the employees. So we would hope that whatever this new business model—and we use all these cliches to describe the future—reform, business model—what are we going to do? Let us put on the table what it is we are going to do, and I am saying there should be some continuation of service to the American public at reasonable cost without paying greater concern for the interests of the major areas of the country.

Mr. DAVIS. Mr. Young.

Mr. YOUNG. Congressman Davis, as the committee wrestles with the issues of postal reform, I hope there comes a time when things other than finances are examined. I do not like to politicize a tragedy, but there has been some conversation around the table, you all have been victimized by it yourself, by bio-terrorism and the results of bio-terrorism. And when I testified before the Commission I reminded them, "just think what would happen if we had a fragmented or privatized Postal Service with 60 or 70 companies involved in the mix." How would we ever contain that as quickly and as well as we did, notwithstanding the fact that it took the lives of two of Bill's members? So, it was not quick enough.

I just think that you have to decide as a public policy matter, what role you want the Postal Service to play, and more importantly what role do you want the postal employees to play. Then it comes down to balancing that with the needs of the business community, the mailers, and the people that are footing the bill for the cost of the Postal Service. And I hope that this committee looks

really carefully at the Commission's recommendations because I am very concerned about giving too much authority to an independent regulator who would not be responsible to any of you, in the area that I will just coin as public policy arena. Why let an independent regulatory body determine what constitutes universal service, when you all are the ones that are going to hear the complaints from it? If they cut service off in Chicago, they are not going to go to the independent regulator to complain, they are going to come to you. So I would think if I were a Congressman, I would want to keep some control of that, so I could be responsible to the people that I represent.

And I just hope as we get through this—it seems like everybody focuses, and I understand this, on the finances, because right now we are in financial trouble. And I am not saying you do not need to focus on that, I am saying I hope and I pray that does not become the sole focus of postal reform. There is a lot more needed than just what financially would put us in a better position, in my perspective.

Mr. HOLTON. And when you talk about universal service, if you talk about the service that my members provide, we are usually the last mile of the way, when it comes to delivering the Postal Service, and we serve a lot of customers in rural America who, if you change the Postal Service too much—and I think you used the word awhile ago—privatization—if privatization comes along that is we have to make a dollar and we have to satisfy stockholders and shareholders. But if you are going to define universal service, it has to include those people that live at that last mile of the last rural route, wherever it happens to be. And you have to be careful, because if you start breaking it apart, those are the people in America that are going to be most affected, because where the work gets done the most is where it is going to be most profitable. And then you are going to have a Postal Service that is fragmented and it is not going to provide that universal service.

So I would hope that we would pay close attention to that as we move forward and realize that the Postal Service is one of the institutions of America. A study that was done by the Presidential Commission itself found it was one of the most admired, trusted agencies in the government. They all believe that the Postal Service has done a good job as it is. But we just have to find ways to make sure that that universal service can continue without affecting the price too much.

Mr. HEGARTY. While downsizing is happening now, Congressman Davis—I noticed in your opening remarks you said you were concerned about excessing, we are concerned about that as well—we have a protection built into our collective bargaining agreement that when excessing occurs at a location, any inconvenience to employees should be cut to a minimum. To that end, we have established a task force with the Postal Service at the headquarters level to meet on Article 12 issues, whether it be moving employees from plant A to plant B, because of a consolidation, or whether it be just downsizing a specific plant. So we are working with the Postal Service, but it is a big concern of the Mail Handler Union. And we do not want downsizing and excessing to take place just for the sake of change. We want it to be legitimate.

And it leads me to the Postal Network Optimization Commission that the President's Commission recommended, which I think is a terrible idea. I think that takes the flexibility and the decision-making authority away from the Postal Service, to make the decisions that they need to make as a business, and puts it into somebody's hands who I do not think would understand the business. So we are against the PNOC, as it is called.

As far as outsourcing, I think outsourcing, subcontracting, whatever you want to call it, has been shown to be a failure many times to the Postal Service. A prime example is the Emery contract for the processing of priority mail. That contract lasted for 4 or 5 years; it was a colossal failure. It cost the Postal Service millions of dollars and it showed that postal employees process that mail more efficiently and better than a private company could, and I believe the Board of Governors' Nick McWhorter commented that it was the biggest mistake that the Board of Governors ever made, authorizing the outsourcing of the priority mail network. We have a similar situation now with the mail transport equipment network. It was subcontracted and I believe a recent study showed that the figures that was based on were incorrect, and that the Postal Service is actually losing money on that deal as well.

As far as privatization outright, having private companies performing some of the service, I agree with President Young on that. I think it would be a nightmare, to try and track packages or letters with a biological or hazardous material in them. The other thing is we cannot lose sight that private companies are in business to make money. They are not in business to provide a service to the American people, and that is what the Postal Service does, and we do not want the service to suffer.

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

Mr. MCHUGH. I thank the ranking member. Just for the record, I want to respond to President Young's comments on universal service which, given my district where my largest community is 29,000, I kind of have an interest in that. I totally agree personally with what you say. I would be willing to bet, and we have been talking to Danny Davis and his people and the ranking member on the full committee, Henry Waxman, that we are going to have for the first time—because as you gentlemen know there is no definition of universal service. And that concerns me, because I think the inclination in these fiscally challenging times would be to define it less than what I would like to see, that we have the Postal Service, not an independent body, look at it and then come back to us, because that should be—I agree, Bill, that should be our prerogative, and our responsibility, because you are right, if we lose coverage to Pierrepont Manor—and nobody in this room except maybe Robert Taub, my chief of staff, knows where that is, and that is where I live, with about 214 people—if they lose universal service, they are not go anywhere but—they know where I live, put it that way. So, that is an important issue, and I promised not to editorialize too much any more. With that I would be thrilled to yield to my friend and colleague from Virginia, Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman.

As you noticed from some of the testimonies, when they were talking about the Members of Congress who have been very involved in this, my name was not there. I asked to be on this panel, I know it is a big issue, I want to understand it, because I have to make the same vote Mr. Davis, Mr. McHugh make, and the better I understand it, the better educated I am going to be when it comes time to vote. That is why I wanted to be here, and listening to your testimonies is very, very valuable to me. The more I hear—it is too bad that every Member of Congress cannot hear this, because it impacts every single constituent of every single Member and I think the more they learn, the more they understand, the better they are going to be when it comes time to vote on this sometime down the pike.

I have several questions, but I am going to have to narrow them down to a couple. I want to start with Mr. Burrus. In your testimony, you called the Commission's recommendation to limit future worksharing discounts to costs avoided simply not good enough. How do you suggest deriving a system to share those costs to preserve important customers and yet maintain universal service? We are talking about universal service. I would be interested to know what your opinion is on that.

Mr. BURRUS. I think the effort to develop a system to determine whether or not worksharing discounts exceed or are under the costs avoided by the Postal Service, is a task that should be best left to the Postal Service and not be considered by Congress. All our union seeks is a simple statement that if there are to be worksharing discounts, and there will, they should not exceed costs avoided. Not to get into these specifics of any specific discount but to set the standard, set the bar that all future and all past discounts will be measured against. That is our objective. Human interaction leads to abuses and argument suggests that interaction has led to discounts that resulted in the Postal Service subsidizing private entities.

If we perform a service that has a certain value to it, if the private sector performs that service they should do it cheaper than the Postal Service, or at least at the same cost. We have absolute proof and we are willing to slug this out before the Rate Commission, or whatever body is set up, to prove our case. But we know without any doubt that there are great incentives added to those discounts to continue those private entities in their business endeavors.

A large enterprise out there has hundreds of millions of dollars invested, and that is all dependent upon the setting of the discount. So questions come into play, not only whether or not it exceeds the costs avoided, but what the impact of that discount would be on that newly established business in the private sector. And we think that is becoming very dangerous, the payers of those mistakes are the average ratepayer. I took to the committee the other day two letters I received at my home, both first class. One, the postage paid was 37 cents the other was 27 cents. The one for 27 cents was put in the Postal Service in Greenville, NC. The one for 37 cents was put in the post office in Washington, DC. So, the 27-cent piece had no transportation, I mean it had transportation cost attached to it, the 37-cent piece had no transportation attached to it. Yet,

there was a 10 cent difference in the postage paid for two first class pieces. And I think those judgments—there should be a standard fee applied, a perfectly reasonable standard.

Mr. SCHROCK. Help me understand why the 30—I should know this but, help me understand why the 37-cent did not have a transportation cost.

Mr. BURRUS. It was put in the mail in Washington, and I live in Washington.

Mr. SCHROCK. OK, I guess I think everybody lives in Chicago, and they do not. I understand.

Mr. BURRUS. While the one put in the post office in Greenville had to be taken to Washington.

Mr. SCHROCK. I see.

Mr. BURRUS. It paid 10 cents less postage than the other piece that they could have delivered to me by hand.

Mr. SCHROCK. Now I should know the answer to this too. Who sets the rates for the businesses, is it you all or is it——

Mr. BURRUS. No, the Postal Rate Commission.

Mr. SCHROCK. Postal Rate Commission.

I want to ask all of you this question. This is one that has been on my mind for a long time, and I find it interesting, your views on the ability of the Postal Service to participate and compete with businesses in non-postal areas. Folks at the D.C. headquarters decide what businesses to get into and it is your members that are responsible for implementing them. And do you think there should be limits on business ventures by the Postal Service?

Mr. YOUNG. My view is I do not know about limits, Congressman, but I definitely think the Postal Service has got to be allowed to explore new sources of revenue, because unlike my colleague to my right here I am pretty much convinced that this loss of first class mail is not a cyclical thing, it is something that is being created by the alternate electronic means that are available to people, and in my judgment this problem is going to get worse and worse as we go along and not better and better.

Having said that, I have been meeting with some of the competitors, to be honest with you, and I have been talking to the CEO of UPS and other competitors, because I understand that allowing us into some markets can be trampling on other people's—where they are at now, and they are going to have some concerns with that. In my testimony, I suggested to you all that I think we can strike a balance, if everybody is interested in the survivability of the Postal Service—and look, the CEO of UPS told me they do $200 million worth of business with the Postal Service every year, that they are not interested in carrying letters, that their business is packages and really packages over 1 pound. So I was encouraged by that. I just think what should happen is we ought to take the approach that my union has been taking since 1993 to be honest with you. We have been meeting with all of the stakeholders and trying to consider everybody's view and trying to let everybody get into this so we do not cripple anybody or hurt anybody. All of us working together have the same objective: to improve the viability of the U.S. Postal Service because it serves us all, in one capacity or the other.

Mr. SCHROCK. Dale.

Mr. HOLTON. I do not know that I have an opinion on non-postal-related business, and what I think of are retail items in the postal lobby, which I look at as more of a convenience for customers that promote—if you look at a lot of it, promote philatelic items, maybe T-shirts and mugs, and that kind of thing. But, I understand what Bill is saying about the other things out there, that the Postal Service needs to have the ability to look into the other ventures that might be postal related, and if they are not then those things need to be carefully monitored to make sure we do not get into a different business.

But I have always taken the perspective that the Postal Service is a business that has to survive and do whatever it can, as long as it is within the bounds of what the law says. So I guess that is where I am with non-postal-related business ventures. What we can do to help the Postal Service survive I would be in support of, but I would not want it to go too far to a point where it infringes on other people, other business.

Mr. SCHROCK. Other commercial ventures.

Mr. HOLTON. Right.

Mr. SCHROCK. Mr. Hegarty.

Mr. HEGARTY. I believe they should be allowed to engage in retail operations that are reasonably related to the postal business. As Dale mentioned, T-shirts, lapel pins, if some one buys a T-shirt, hats, things like that—if they buy a T-shirt or something like that at the post office while they are buying stamps I do not think that hurts any competitors. I do not think that is one less T-shirt they are going to buy.

Mr. SCHROCK. But if you start selling groceries, that is where it stops.

Mr. HEGARTY. There you go. If they can engage in moneymaking ventures that will help them maintain universal service, although we have not defined it yet, or help them keep their head above water financially, I think it is a good thing for the Postal Service.

Mr. SCHROCK. That is probably something we need to do, clearly define universal service. Because is it here, is it here, is it here. Mr. Burrus.

Mr. BURRUS. Yes, I support the Postal Service's right, new right, to engage in new enterprises, understanding clearly that it is opening up Pandora's box. There will always be the question of cross-subsidization.

Mr. SCHROCK. Cross what?

Mr. BURRUS. Cross-subsidization: taking the profit from first class mail that is protected by the monopoly and using that profit to subsidize a new market. There would be the other issues of whether or not the business the Postal Service is entering is best served by the private sector and whether or not a government agency should be involved in such activities. It would open up a whole range of issues that the Postal Service would have to respond to, but I do favor their expanding their base.

There are many services we can perform in our current environment. The recently passed Medicare legislation, prescription drugs, there is no better vehicle to provide that service to the American public than the U.S. Postal Service. We are in every community. We already serve as a service with draft registration, and other

places that have a hard time with their drivers' licenses, particularly Washington, DC, they could use some postal facilities for something like that.

So we could expand under our existing charter, but I do favor expanding that charter to permit commercial. I caution everyone, the Postal Service has had attacks upon its share of the market in the past. We have survived the telephone, the telegraph, and I believe we will survive technology.

Mr. SCHROCK. You will survive these things.

Mr. BURRUS. Yes, I think we will survive, because every day I look at my mailbox. My mail is not determined by the number of letters I have sent, the mail I receive goes up every month, every month. I receive more letters today than I did 10 years ago.

Mr. SCHROCK. Oh, I am on every sucker list in the world. Yeah, I really am.

Does the sale of those items like the hats, the shirts, the cups, does that really impose a hardship on those great folks behind the counters?

Mr. BURRUS. I was pleased to hear from the Mail Handlers that they would like for my members to sell T-shirts and caps; we have been there, done that. That was not a major revenue generator. It caused some distraction in our lobbies. If they expand their base, I certainly would not suggest that they go into the direction of T-shirts and mugs.

Mr. SCHROCK. And if it is not a major revenue generator, why are they doing it?

Mr. BURRUS. In most places, I think they have scaled back, they are not doing much there.

Mr. SCHROCK. Oh, they are not, OK.

Mr. BURRUS. It was, by and large, a failure.

Mr. SCHROCK. Thank you. I have really enjoyed listening to you all. Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman. I promised not to editorialize, but I was lying. I happen to be one of the people that believe that parcel post and packages by the Postal Service is not competing against the private sector. I happen to believe the private sector is competing against the Postal Service, because long before there were these—and they are wonderful companies—these private companies doing this, the Postal Service was doing it. And I know, back to Pierrepont Manor, you remember that I mentioned it a few moments ago, when you use one of these private companies you get a surcharge because you are in a zip code that is not quite as profitable. I think it is interesting that some of these private companies have created a relationship with the Postal Service whereby you are carrying their packages the last miles. So I mean, I reject that, I do not think there ought to be a Postal Service used car lot, and we need to ensure that we are focusing the——

Mr. SCHROCK. I think some Members liked that, they shook their heads yes.

Mr. YOUNG. Selling cars.

Mr. MCHUGH. Under the current law you could. So, I mean, we have to strike a balance here, and I do think there are things we can do, in fairness to private companies, to level that playing field absolutely, and we need to do that.

I would also like—just a question, because I know Bill Burrus said he had been in there 50 years.

Mr. BURRUS. 1954.

Mr. MCHUGH. Now you are under oath, Mr. President. How old are you? Yeah, and then my colleague, from Virginia, says, "Were there not child labor laws back then?"

Mr. BURRUS. You want on the record my age under oath?

Mr. MCHUGH. You can take the fifth.

Mr. BURRUS. 67.

Mr. MCHUGH. Are you really? God bless you. You do not look it. I would like to say I would like to look that good when I am 67; I would like to look that good now. That is remarkable, my compliments to you.

Mr. Davis, do you have any further questions?

Mr. DAVIS. No, I am satisfied with listening to this panel and, you know, I want to invite them back again when the weather is a little different, but we were pleased that they have been here.

Mr. MCHUGH. Sir?

Mr. YOUNG. Could I just have an opportunity to—I would just like to put one thing on the record if I could. I was advised of the outcome of the Senate hearings yesterday, and I want to issue a formal apology to the Congress on behalf of the members of the National Association of Letter Carriers. As I reflect back over the years, I think too often we ran to Congress and complained because we were unable to adjudicate our differences with postal management. And I think what gets done is that led a lot of Congresspeople to think that we need your assistance. And I just wanted to—in the arena—we definitely need your assistance, believe me when I tell you that, but in the arena of collective bargaining I just want to have one last chance to convince you that I am now of the mindset that was just because we were not sophisticated enough to deal with the issues we had to deal with. And I am more encouraged now than ever that the capacity to engage in meaningful labor relations is built into the system that we have, it does not need to be messed with. And I am terrified that somebody is just going to discard the 34 years that it took us to learn this process and replace it with something that is going to make us start all over again, and then there will be screaming and hollering when neither one of us can make an immediate adjustment to it.

So I thank you, for giving me that opportunity and on behalf of over 300,000 active and retired letter carriers, I apologize if we have misled Congress into believing that we are unable to deal with our own labor relation issues. And I am here to tell you that I do not feel that way and my members do not feel that way, and I hope that the past has not done too much to be able to convince you that is not so. And I thank you for allowing me to say that, sir.

Mr. MCHUGH. Well, President Young, I appreciate that. You know, as I mentioned in my opening comments, we worked very hard over more than 8 years to try to do something that is necessary, do something that is positive, and do something that is achievable. I mean, we could go through the academic exercise of talking about postal reform, and I have been doing it now for over

8 years. The only true measurement on Capitol Hill of success is passing a bill and getting it signed, and the agreement we had last year, for a whole host of reasons, put aside, did not bring into its context the kinds of things that you are talking about.

I fully respect the President's Commission in the recommendation that they made in this area. They were charged to look at the full range of issues and they did, I think, outstanding work. But speaking for myself, I do not see a political small calculation that allows us to go in and address the issue, particularly that you just spoke about, in a successful way. And I do think we need to take some positive steps, and I might be proved wrong there, I am not trying to prejudice this process, and we are trying to keep an open mind and we will. Your apology is appreciated. I am not sure it is necessary, but it is appreciated and taken not just for the record, but into our recognition.

So, gentlemen again, thank you, I was trying to be, and I hope I was very sincere about the amazing work that your employees do. And the service that you provide to every American, each and every day, God bless you. Thank you.

[Pause.]

Mr. MCHUGH. I would like to welcome the members of our second panel. And as happened with the first panel, the first order of business, prior to my having the honor of introducing them, is to ask them to rise and raise their right hands, so we can do the oath as required under the committee rules.

[Witnesses sworn.]

Mr. MCHUGH. The record will reflect all three of our distinguished panelists responded in the affirmative.

We have next, in the order they are presented here and in the order I see in which they are seated, Mr. Olihovik, who is national president of the National Association of Postmasters of the United States. Now we welcome Mr. Steve LeNoir, president of the National League of Postmasters, and Mr. Vincent Palladino, president of the National Association of Postal Supervisors. Vince, good to see you again. Gentlemen, thank you so much for being here. Thank you for you patience.

As I noted with the previous panel, we do have your written testimony, and without objection they will all be entered into the record in their entirety. Hearing no objection, so ordered. To the extent it is possible, we would ask you to summarize those, and gentlemen, our attention is yours.

So, with that, President Olihovik, welcome sir, we look forward to your comments.

STATEMENTS OF WALTER M. OLIHOVIK, NATIONAL PRESIDENT OF THE NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES; STEVE D. LENOIR, PRESIDENT OF THE LEAGUE OF POSTMASTERS; AND VINCENT PALLADINO, PRESIDENT OF THE NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

Mr. OLIHOVIK. Mr. Chairman and distinguished members of the committee, on behalf of the 42,000 members of the National Association of Postmasters of the United States, I welcome the opportunity to share with you my thoughts regarding the need to update

the Postal Reorganization Act of 1970. I would be remiss if I did not thank you, Mr. Chairman, for your strong leadership with the introduction of the Postmasters Equity Act recently signed into law by President Bush. Congressman Davis and Congressman Schrock, you also have my deep appreciation for your strong support for that bill as well.

The consistent erosion of first class mail even in times of plenty is an ominous sign for the Postal Service. During the third quarter of last year the Gross Domestic Product rose by an impressive 8 percent. Yet, the Postal Service projects a 3.2 percent drop in first class mail volume.

As you know, this committee assisted the Postal Service, if only temporarily, by passing Public Law 108–18. The CSRS legislation provided a short reprieve; however, Congress needs to revisit the issue as part of your postal reform effort. It is important to reverse the decision to shift the military retirement liability onto the Postal Service. In addition, the Postal Service must be permitted to use the escrow that will accrue as the result of the CSRS recalculation. Over the last 2 years, the Postal Service has successfully reduced costs to balance shrinking revenue. However, the Postal Service cannot continue to chip away at costs without influencing the quality of mail service that Americans expect and demand. Rather, we need the tools and flexibility that are essential to grow revenue. President Bush has emerged as a strong ally in your effort to push forward.

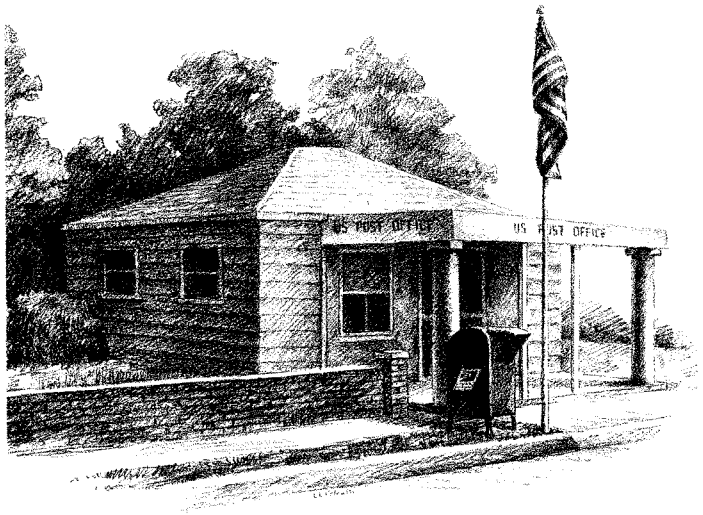
The fundamental mission of the Postal Service remains unchallenged. The institution performs an inherently governmental function and it should continue to provide affordable universal postal services. This policy matter Congress must reserve to itself and not delegate to a postal regulator. Universal service encompasses a nationwide retail and delivery network that reaches into every city and town. It is clear that under current law and postal regulations, the Postal Service may, and in fact does, close post offices. This authority is not to be taken lightly. NAPUS urges Congress to reject attempts to weaken those rights afforded to American communities. In many situations, this is the only opportunity for communities to appeal post office closures.

NAPUS has worked with communities in safeguarding their legal rights to protect their post office. As part of this effort, NAPUS publishes and circulates "The Red Book: A NAPUS Action Guide for preventing the Closing or Consolidation of Your Post Office." In addition, NAPUS has worked closely with the Congressional Rural Caucus to safeguard a community's due process rights. Mr. Chairman, I request that the committee include the NAPUS Action Guide as part of the official hearing record.

Mr. MCHUGH. Without objection, so ordered.

[The information referred to follows:]

The
RED
Book



a NAPUS Action Guide

for preventing the
closing or consolidation
of your post office

▪ PURPOSE ▪

The purpose of this guide is to provide the information necessary in the event a post office comes under consideration for closing or consolidation. The guide is designed to help prevent the *arbitrary* closing or consolidation of any post office.

Title 39, *United States Code*, Section 404(b), is the law of the land in regard to the closing and consolidation of post offices. Regulations outlined in Sections 123.6 and 123.7, of the *Postal Operations Manual*, U.S. Postal Service, also apply. It is vital that those who will be involved in helping prevent post office closings and, possibly, later appeals, be very familiar with both the *U.S. Code* and the USPS regulations.

We cannot emphasize too strongly that the protections afforded by these laws and regulations are of no value if they are not put to proper use. The entire NAPUS organization is available to you for assistance. Please let us know your needs.

Those who would privatize the United States Postal Service remain our biggest threat with respect to wholesale closings. It is important, therefore, that we be on the alert to possible actions by the USPS to close or consolidate our post offices.

PREFACE

From the Official Constitution of the National Association of Postmasters of the United States

Article II
Purposes

Section 2. The primary purpose of this organization shall be to: (a) to provide the Postmaster of the U.S. Postal Service to foster a favorable image of public service to assure the success of the mails the best service possible to cooperate with other groups and levels of postal management to the achievement of common goals and to cultivate the welfare and enhance the happiness of its members.

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12/97

NATIONAL ASSOCIATION OF POSTMASTERS OF THE UNITED STATES
8 HERBERT STREET, ALEXANDRIA, VA 22305-2600
(703) 683-9027; FAX (703) 683-6820

General Procedures

The following are some of the more important aspects of the laws and regulations governing the closing or consolidation of post offices.

1. A decision to discontinue or suspend services of a post office must address each of the following matters:

(a) responsiveness to community postal needs;
(b) effect on the community;
(c) effect on the employees;
(d) an analysis of the economic savings to the Postal Service;
(e) other factors, and
(f) a summary that explains why the proposed action is necessary (*POM, 123.634, a through f*).

2. The time frame (*POM, 123.612*) calls for a 60-day period for public comment after the release of the proposal to close. After comments are received and the Postal Service decides to proceed, the proposal is sent through channels to the Chief Marketing Officer and Senior Vice President.

If the closing or suspension is approved at Headquarters, the district manager will post such final notice in the affected post office. No office can be closed sooner than 60 days after this posting. The law then provides a very important 30 days for appeals by the customers to the Postal Rate Commission (PRC). The PRC then has 120 days for review.

3. An active postmaster, being part of management, must be careful not to take an open and active stand against a post office closing. It is fine to know what to do and to answer questions from the public. It would be quite another thing to become so active in the matter as to put yourself in jeopardy. Good judgment must rule.

Suggestions for Action by Customers of Post Offices

1. Organization of your effort is vital to any cause. This will allow you to share common information and purpose.

2. Circulate a petition to keep the post office open with a postmaster as the local manager (*see sample petition on page 5*—Ed).

3. It should be considered whether an attorney is to be retained, and if so, how the cost will be handled.

4. The Postal Service will probably distribute questionnaires to those affected in the community. The local group should be ready for this and see that the proper replies are made. Replies should address, as appropriate, the five factors as prescribed by law that the Postal Service must follow in making a determination to close or consolidate (*Title 39, United States Code, Section 404(b).*)

5. It is important to schedule a public organizational meeting prior to the postal-sponsored meeting, preferably the same day or night, an hour or so before the postal meeting. This overcomes the difficulty of getting citizens out to two meetings on different days.

Invite retired postmasters of the NAPUS closing prevention committee to the meeting to explain the consequences of the proposed closing, inform the citizens of their rights under law to protest the closing or consolidation and answer any questions that may be asked. Also, this meeting will allow the citizens to appoint several good speakers to make their protests at the postal hearing, thus averting contradictions among those in attendance.

Planning should include consideration of retaining an attorney and means for paying for such legal aid, identifying an individual who can videotape the entire procedure of the postal-sponsored meeting and appointing someone to record all the procedures of the postal meeting, as well as recording the names and titles of the postal officials conducting the meeting. Seek out local television and radio coverage of the postal-sponsored meeting and invite your U.S. senators and representative, or their designees, to attend.

6. An amendment to Title 39 went into effect March 6, 1977, requiring a public hearing if an office is scheduled for closing. When public hearings are conducted, see to it that a good group is present and prepared with proper comments and questions. If an attorney has been retained, he or she should attend the meeting.

7. Get the story of the proposed post office closing to the area newspapers, radio and TV stations. Their assistance and understanding can be very helpful.

(continued)

SUGGESTIONS FOR ACTION BY CUSTOMERS OF POST OFFICES
– continued –

8. Your contacts with senators and representatives are vital in these situations—write, call or personally visit with them.

9. Influential persons in the community and area should contact appropriate Postal Service managers, state legislators, judges, lawyers, ministers, businesspersons and others as necessary.

10. Since many requirements of the law must be met by the Postal Service, a diary of all activities should be kept, with as many specifics as possible. This may be very important to your efforts, should an appeal be made to the Postal Rate Commission.

11. An appeal against a proposed closing (*see "Role of the Postal Rate Commission," page 15*) should be mailed to the PRC early enough to ensure **it reaches Washington, DC, within 30 days** from the date the Postal Service posted its final determination. The address of the PRC is:

OFFICE OF THE SECRETARY
POSTAL RATE COMMISSION
1333 H STREET NW SUITE 300
WASHINGTON, DC 20268-0001

The Postal Rate Commission will also furnish detailed information regarding the filing of briefs.

The National Association of Postmasters of the United States (NAPUS) is headquartered at 8 Herbert Street, Alexandria, VA 22305-2600; (703) 683-9027. NAPUS is prepared to provide helpful information to local citizens, and has a nationwide network of retired postmasters ready and willing to provide assistance. A phone call will bring an immediate response by a retired NAPUS postmaster in your area who can help in this matter.

Remember, only the *customers* of a targeted post office may work to prevent its closing or consolidation. *Active* postmasters and postal employees are *prohibited* from activity in this area. NAPUS will provide all the information on steps you may take, but the final responsibility rests with the local citizens.

■ SUGGESTED FLYER TO ISSUE TO CUSTOMERS OF A POST OFFICE TARGETED FOR CLOSING OR CONSOLIDATION.

Attention Postal Customers of (*insert name*) Post Office:

The Postal Service has issued notice that the (*insert name*) Post Office will likely be (*closed or consolidated*) in the next 120 days, pursuant to provisions of the Postal Reorganization Act of 1970 and federal law.

The procedure allows customers a 60-day period from the date of the initial notice to evaluate the proposal and offer comments. Thereafter, the Postal Service has another 60 days in which to make a final determination on the proposal.

Local customers of the (*insert name*) Post Office must take immediate action if the present status of our post office, a U.S. post office operated by career postal employees, is to be retained.

The Postal Service must schedule a public meeting to explain its proposal and to hear comments from postal customers. When this meeting is scheduled, we must be organized to voice our disapproval of any proposal for a contract community post office, rural delivery or consolidation as a branch or station of another post office.

Written protests against the closing or consolidation of our post office should be sent immediately to the district manager, Customer Service and Sales, at (*insert address*).

We also must:

• notify and seek the assistance of our area's news media (newspapers, radio, television) in presenting our side of the story to the public;

• immediately alert our congressional delegation, and state, city and county officials of the proposal, and seek their support in retaining our post office in its present status.

• immediately circulate a petition among all customers of our post office protesting the proposal and supporting the present status of our post office.

By all means, do not accept anything less than the present status of your post office. Do not accept a contract community post office, rural delivery or consolidation with another post office. Once you do, you forfeit any further recourse to the protection offered by the Postal Reorganization Act of 1970.

■ **SUGGESTED NEWS ARTICLE FOR CITIZENS TO SUPPLY TO LOCAL MEDIA IN A COMMUNITY WHERE A CLOSING OR CONSOLIDATION OF A POST OFFICE IS BEING PROPOSED BY THE U.S. POSTAL SERVICE.**

The United States Postal Service, in a notice posted in (*insert name*) Post Office and a form letter to customers proposes to (*close or consolidate*) the post office.

This is the first step, under law, that the U.S. Postal Service must take prior to closing or consolidating a post office. This notice must be given 60 days prior to a final decision on the matter to allow time for local customers of the post office to evaluate the proposal and offer comments. This is a stipulation of the Postal Reorganization Act of 1970, and of Title 39, U.S. Code, Section 404(b).

Postal officials are required by law to schedule a public meeting with customers of any post office proposed for closing or consolidation. Locally, this meeting is scheduled for (*insert date and time*) at (*insert location*). Written comments may also be submitted to the local district office of the U.S. Postal Service, located at (*insert address*).

Local citizens served by the (*insert name*) Post Office should seriously consider the consequences of the U.S. Postal Service's proposal and be prepared to voice their concerns at the (*insert date*) meeting. Only the citizens of the community may take action to prevent the closing or consolidation of their post office, and prevent service from being transferred to a contract community post office or station and/or rural or cluster box delivery.

To preserve their post office as it now exists—a regular United States post office operated by career postal employees—local citizens must speak up now.

In addition to the 60-day period provided by law for customer comments, the law also provides appeal rights for local citizens if the final decision is in favor of closing or consolidation. The appeal from local citizens must be in the hands of the Postal Rate Commission in Washington, DC, within 30 days after the U.S. Postal Service's written determination for closing or consolidation.

Local citizens should take notice that once the (*insert name*) Post Office has been closed or contracted out, there is very little possibility of it ever returning to its present status.

■ **SAMPLE PETITION TO BE SIGNED BY ALL CUSTOMERS OF THE POST OFFICE TARGETED FOR CLOSING OR CONSOLIDATION.**

(*insert name*)
DISTRICT MANAGER,
CUSTOMER SERVICE AND SALES
UNITED STATES POSTAL SERVICE
(*insert city, state, ZIP Code*)

We, the citizens and customers of the (*insert name*) Post Office hereby protest any change in the present status of our post office.

It is our desire to retain our post office at its present status—a United States post office operated by a postmaster and career postal employees.

We have many concerns, among them the sanctity of the mail and the inconvenience your proposal presents to us in delivering and sending the mail, particularly accountable mail. We are especially concerned over what effect your proposed action would have regarding the purchase of postal money orders. We are also well aware of the documented abuses possible through a contract mail station.

The Postal Reorganization Act of 1970 calls for providing a maximum degree of effective and regular postal service to rural areas, communities and small towns where post offices are not financially self-sustaining.

We do not feel your proposals meet these criteria.

Sincerely,
Customers of the (*insert name*) Post Office:

(*Leave ample space for customers of the post office to sign their names and provide their mailing addresses. They should also write the date they sign the petition. Be certain that you keep a duplicate copy of the petition.*)

■ **SUGGESTED LETTER TO CONGRESSIONAL DELEGATION TO BE SENT IMMEDIATELY UPON RECEIPT OF THE FIRST NOTICE OF ANY PROPOSED CLOSING OR CONSOLIDATION.**

(insert date)

SENATOR (*insert name*)
SENATE OFFICE BUILDING
WASHINGTON, DC 20510-0001

or

REPRESENTATIVE (*insert name*)
HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-0001

Dear Senator (or Representative) (*insert name*):

The U.S. Postal Service has served notice to the customers of the (*insert name*) Post Office of a proposal to (*close or consolidate*) the post office. It is doing so under provisions of the Postal Reorganization Act of 1970 and federal law, and over our objections.

Under provisions of the act, the Postal Service is obligated to provide a maximum degree of effective and regular postal service to rural areas, communities and small towns where post offices are not self-sustaining. The Postal Service's proposed action will not serve the best interests of our postal customers.

(*If the proposal is for a contract community post office, use the following:*)

The Postal Service is proposing a contract community post office to replace our present regular post office. We have concerns regarding the sanctity of the mail under this situation. Also, contract post offices may be sub-leased and operated by unqualified clerks who have never taken a postal exam for the post office.

Once a contract post office replaces a regular post office, we are no longer protected by provisions of the Postal Reorganization Act. Termination of the contract by either party for cause leaves us at the mercy of the Postal Service. The Postal Service is free to provide whatever type of service it deems advisable, with no recourse available to us.

(*If the proposal is for rural or cluster box delivery, use the following:*)

The Postal Service has made a decision to close our post office and provide us with rural delivery. We do not feel we will be getting the maximum service the Postal Reorganization Act calls for with this type of service. Inconvenience in purchasing stamps and money orders, and in sending accountable mail, such as a certified letter, are among the problems we foresee. The same holds true for the receipt of accountable mail.

Invariably, we will be left with a pick-up notice that will require a (*insert distance*)-mile trip to the post office at the neighboring town for pickup. We also have concerns regarding the sanctity of the mail with non-career carriers and the loss of identity for our community.

(*If the proposal is for consolidation with a neighboring post office, use the following:*)

The Postal Service is proposing the consolidation of our post office with the (*insert name*) Post Office. Postal officials point to this as a money-saving move, a contention that we dispute. We protest the loss of our postmaster and community identity. Someone will still have to staff the office if it's consolidated with the (*insert name*) Post Office. There are no savings in this situation.

A higher-level clerk in charge will command as much in salary as our postmaster. With our own postmaster, we have someone to hear our problems, and take our complaints and compliments, rather than our being referred to an individual at the (*insert name*) Post Office.

(*Use the following closing paragraph in all instances:*)

We appreciate your consideration of our position and encourage you or a representative to attend a public meeting the Postal Service has scheduled for our community on (*insert date and time*) at (*insert place*). We appreciate any support you can give us in our fight to retain our post office in the same status as now exists—a U.S. post office operated by a postmaster and career postal employees.

Thank you.

Sincerely,

(*Secure signatures of as many postal customers as possible in the community*—Ed.)

■ **SUGGESTED LETTER TO POSTAL RATE COMMISSION ONCE POSTAL SERVICE SERVES NOTICE THAT A FINAL DECISION HAS BEEN MADE TO CLOSE OR CONSOLIDATE A POST OFFICE. (MUST BE IN THE HANDS OF THE COMMISSION NOT LATER THAN 30 DAYS AFTER THE DECISION HAS BEEN POSTED BY THE POSTAL SERVICE.)**

(insert date)

POSTAL RATE COMMISSION
1333 H STREET NW, SUITE 300
WASHINGTON, DC 20268-0001

The Postal Service has informed us of a decision to (*close or consolidate*) our post office by (*insert date*). This action is being taken after meeting the provisions of the Postal Reorganization Act of 1970, and over our protestations.

We, the customers of the (*insert name*) Post Office, vigorously protest this action, in view of the provision in the Postal Reorganization Act that calls for the Postal Service to provide a maximum degree of effective and regular postal service to rural areas, communities and small towns where the post office is not self-sustaining.

(*If the decision is to close and offer rural delivery, use the following:*)

The Postal Service's decision to close our post office and provide rural delivery service raises questions concerning the sanctity of the mail and the risks involved in the handling of mail by non-career employees. We also foresee inconveniences in purchasing money orders and stamps, and sending accountable mail. We have the same concerns regarding the receipt of accountable mail, such as certified letters, registered letters and CODs.

(*If the decision is to contract through a community post office, use the following:*)

The Postal Service's decision to convert our post office to a contract community post office raises questions concerning the sanctity of the mail and the risks involved in the handling of mail by non-career employees. We also know that the lessee can sub-lease the contract and hire substandard help, and that the contract can be terminated with cause by either party.

We know that, once we are deprived of our present post office, we no longer come under the protection of the Postal Reorganization Act and are at the mercy of the Postal Service.

(*Should the decision be to consolidate with a neighboring post office, use the following:*)

The Postal Service's decision to consolidate our post office with the (insert name) Post Office is being done over our objections. This will mean the loss of our identity as a community. We will not have a postmaster to whom we can take our problems, complaints and compliments. We will be directed to a distant postmaster in the home office of our station.

We cannot see any savings to the Postal Service under this arrangement. The clerk in charge of the station will be earning as much as our postmaster and, more than likely, will not be a resident of our community.

(*Use this last paragraph in all cases listed above:*)

We feel that, as citizens of the United States, we are entitled to the same efficient postal service provided to our counterparts in urban areas. The Postal Reorganization Act is explicit in pointing this out. We petition you, as members of the Postal Rate Commission, to respectfully consider our protest and order the Postal Service to give additional considerations to our service needs.

Respectfully,

(*Secure signatures of as many postal customers as possible in the community*—Ed.)

Provisions of the Postal Reorganization Act Concerning Post Office Closings and Consolidations

Title 39, United States Code, §404, Specific Powers

(a) Without limitation of the generality of its powers, the Postal Service shall have the following specific powers, among others:

(1) to provide for the collection, handling, transportation, delivery, forwarding, returning and holding of mail, and for the disposition of undeliverable mail;

(2) to prescribe, in accordance with this title, the amount of postage and the manner in which it is to be paid;

(3) to determine the need for post offices, postal and training facilities and equipment, and to provide such offices, facilities and equipment, as it determines are needed;

(4) to provide and sell postage stamps and other stamped paper, cards and envelopes, and to provide such other evidences of payment of postage and fees as may be necessary or desirable;

(5) to provide philatelic services;

(6) to provide, establish, change or abolish special nonpostal or similar services;

(7) to investigate postal offenses and civil matters relating to the Postal Service;

(8) to offer and pay rewards for information and services in connection with violations of the postal laws, and, unless a different disposal is expressly prescribed, to pay one-half of all penalties and forfeitures imposed for violations of law affecting the Postal Service, its revenues or property to the person informing for the same, and to pay the other one-half into the Postal Service Fund, and

(9) to authorize the issuance of a substitute check for a lost, stolen or destroyed check of the Postal Service.

(b)(1) The Postal Service, prior to making a determination under subsection (a)(3) of this section as to the necessity for the closing or consolidation of any post office, shall provide adequate notice of its intention to close or consolidate such post office at least 60 days prior to the proposed date of such closing or consolidation to persons served by such post office to ensure that such persons will have an opportunity to present their views.

(2) The Postal Service, in making a determination whether or not to close or consolidate a post office, shall consider—

(A) the effect of such closing or consolidation on the community served by such post office;

(B) ***the effect of such closing or consolidation on employees of the Postal Service employed at such office*** (*bold italics ours*—Ed.);

(C) whether such closing or consolidation is consistent with the policy of the government, as stated in Section 101(b) of this title, ***that the Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities and small towns where post offices are not self-sustaining*** (*bold italics ours*—Ed.);

(D) the economic savings to the Postal Service resulting from such closing or consolidation, and

(E) such other factors as the Postal Service determines are necessary.

(3) Any determination of the Postal Service to close or consolidate a post office shall be in writing and shall include the findings of the Postal Service with respect to the considerations required to be made under paragraph (2) of this subsection. Such determination and findings shall be made available to persons served by such post office.

(4) The Postal Service shall take no action to close or consolidate a post office until 60 days after its written determination is made available to persons served by such post office.

(5) A determination of the Postal Service to close or consolidate any post office may be appealed by any person served by such office to the Postal Rate Commission within 30 days after such determination is made available to such person under paragraph (3). The Commission shall review such determination on the basis of the record before the Postal Service in the making of such determination. The Commission shall make a determination based upon such review no later than 120 days after receiving any appeal under this paragraph. The Commission shall set aside any determination, findings and conclusions found to be—

(A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law;

(B) without observance of procedure required by law, or

(C) unsupported by substantial evidence on the record.

The Commission may affirm the determination of the Postal Service or order that the entire matter be returned for further consideration, but the Commission may not modify the determination of the Postal Service. The Commission may suspend the effectiveness of the determination of the Postal Service until the final disposition of the appeal. The provisions of Section 556, Section 557, and Chapter 7 of Title 5 shall not apply to any review carried out by the Commission under this paragraph.

Postal Service Procedures for Discontinuing a Post Office

Postal Operations Manual (POM), July 1995

123.6 Discontinuance of Post Offices

123.61 Introduction

123.611 *Coverage*

This section establishes the rules governing the Postal Service's consideration of whether an existing post office should be discontinued. The rules cover any proposal to replace a post office with a community post office, station or branch by consolidation with another post office and any proposal to discontinue a post office without providing a replacement facility.

123.612 *Legal Requirements*

Under 39 United States Code (U.S.C.) 404(b), any decision to close or consolidate a post office must be based on certain criteria. These include the effect on the community served; the effect on employees of the post office; ***compliance with government policy established by law that the Postal Service must provide a maximum degree of effective and regular postal services to rural areas, communities and small towns where post offices are not self-sustaining*** (*bold italics ours*—Ed.); the economic savings to the Postal Service; and any other factors the Postal Service determines necessary. In addition, certain mandatory procedures apply:

a. The public must be given 60 days' notice of a proposed action to enable the persons served by a post office to evaluate the proposal and provide comments.

b. After public comments are received and taken into account, any final determination to close or consolidate a post office must be made in writing and must include findings covering all the required considerations.

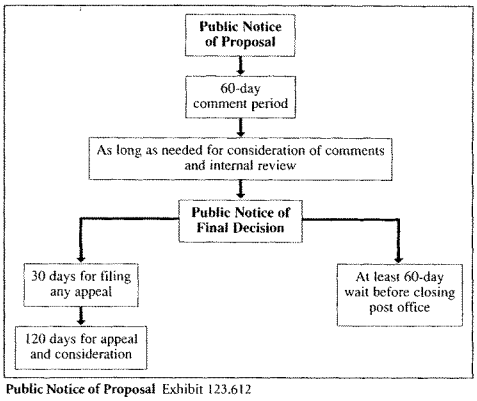
c. The written determination must be made available to persons served by the post office at least 60 days before the discontinuance takes effect.

d. Within the first 30 days after the written determination is made available, any person regularly served by the affected post office may appeal the decision to the Postal Rate Commission.

e. The Commission may affirm the Postal Service determination or return the matter for further consideration, but may not modify the determination.

f. The Commission is required by 39 U.S.C. 404(b)(5) to make a determination on the appeal no later than 120 days after receiving the appeal.

g. A summary table of the notice and appeal periods under the statute for these regulations is in Exhibit 123.612.



Public Notice of Proposal Exhibit 123.612

123.613 *Additional Requirements*

Section 123.6 includes the following:

a. Rules to ensure that the community's identity as a postal address is preserved.

b. Rules for consideration of a proposed discontinuance and for its implementation, if approved. These rules are designed to ensure that the reasons leading a district manager, Customer Service and Sales, to propose the discontinuance of a particular post office are fully articulated and disclosed at a stage that enables customer participation to make a helpful contribution toward the final decision.

123.62 Preservation of Community Address

123.621 *Policy*

The Postal Service permits the use of a community's separate address to the extent practicable.

123.622 *ZIP Code Assignment*

The ZIP Code for each address formerly served from the discontinued post office should be the ZIP Code of the facility providing replacement service to that address. In some cases, the ZIP Code originally assigned to the discontinued post office may be kept, if the responsible district manager, Customer Service and Sales, submits a request with justification to Address Management, Postal Service Headquarters, before the proposal to discontinue the post office is posted.

a. In a consolidation, the ZIP Code for the replacement community post office, station or branch is either the ZIP Code originally assigned to the discontinued post office, or the ZIP Code of the replacement facility's

Postal Service Procedures for Discontinuing a Post Office
– continued –

parent post office, whichever provides the most expeditious distribution and delivery of mail addressed to the customers of the replacement facility.

b. If the ZIP Code is changed and the parent post office covers several ZIP Codes, the ZIP Code must be that of the delivery area in which the facility is located.

123.623 ***Post Office Name in Address***

If all the delivery addresses using the name of the post office to be discontinued are assigned the same ZIP Code, customers may continue to use the discontinued post office name in their addresses instead of the new delivering post office name.

123.624 ***Name of Facility Established by Consolidation***

If a post office to be discontinued is consolidated with one or more post offices by establishing in its place a community post office, classified or contract station, or branch affiliated with another post office involved in the consolidation, the replacement unit is given the same name as the discontinued post office.

123.625 ***List of Discontinued Post Offices***

Publication 65, *National Five-Digit ZIP Code and Post Office Directory*, lists all post offices discontinued after March 14, 1977, for mailing address purposes only if they are used in addresses. The ZIP Codes listed for discontinued offices are those assigned under 123.622.

123.63 Initial Proposal

123.631 ***General***

If a district manager, Customer Service and Sales, believes that the discontinuance of a post office within his or her responsibility may be warranted, the manager must take the following steps:

a. Use the standards and procedures in 123.63 and 123.64.

b. Investigate the situation.

c. Propose the post office be discontinued.

123.632 ***Consolidation***

The proposed action may include a consolidation of post offices to substitute a community post office or a classified or contract station or branch for the discontinued post office if either of the following conditions apply:

a. The communities served by two or more post offices are being merged into a single incorporated village, town or city, or

b. A replacement facility is necessary for regular and effective service to the area served by the post office considered for discontinuance.

123.633 ***Views of Postmasters***

Whether the discontinuance under consideration involves a consolidation or not, the district manager, Customer Service and Sales, must discuss the matter with the postmaster (or the officer in charge) of the post office considered for discontinuance and with the postmaster of any other post office affected by the change. The manager should make sure these officials submit written comments and suggestions as part of the record when the proposal is reviewed.

123.634 ***Preparation of Written Proposal***

The district manager, Customer Service and Sales, must gather and preserve for the record all documentation used to assess the proposed change. If the manager thinks the proposed action is warranted, he or she must prepare a document titled Proposal to (Close) (Consolidate) the (Name) Post Office. This document must describe, analyze and justify in sufficient detail to Postal Service management and affected customers the proposed service change. The written proposal must address each of the following matters in separate sections:

a. *Responsiveness to Community Postal Needs.* ***It is the policy of the government, as established by law, that the Postal Service will provide a maximum degree of effective and regular postal services to rural areas, communities and small towns where post offices are not self-sustaining*** (*bold italics ours*—Ed.). The proposal should contrast the services available before and after the proposed change; describe how the changes respond to the postal needs of the affected customers, and highlight particular aspects of customer service that might be less advantageous as well as more advantageous.

b. *Effect on Community.* The proposal must include an analysis of the effect the proposed discontinuance might have on the community served, and discuss the application of the requirements in 123.62.

c. *Effect on Employees.* The written proposal must summarize the possible effects of the change on the postmaster, supervisors and other employees of the post office considered for discontinuance. (The district manager, Customer Service and Sales, must suggest measures to comply with personnel regulations related to post office discontinuance and consolidation.)

d. *Savings.* The proposal must include an analysis of the economic savings to the Postal Service from the proposed action, including the cost or savings expected from each major factor contributing to the overall estimate.

e. *Other factors.* The proposal should include an analysis of other factors that the district manager, Customer Service and Sales, determines necessary for a complete evaluation of the proposed change, whether favorable or unfavorable.

(***Very often, the USPS fails to meet its obligation with respect to listing unfavorable factors, such as alternative sites or available structures within the community, or the willingness of the facility owner to make required modifications***—Ed.)

f. *Summary.* The proposal must include a summary that explains why the proposed action is necessary and

Postal Service Procedures for Discontinuing a Post Office
– continued –

assesses how the factors supporting the proposed change outweigh any negative factors. In taking competing considerations into account, the need to provide regular and effective service is paramount.

g. *Notice.* The proposal must include the following notice: THIS IS A PROPOSAL. IT IS NOT A FINAL DETERMINATION TO (CLOSE) (CONSOLIDATE) THIS POST OFFICE.

(1) If a final determination is made to close or consolidate this post office, after public comments on this proposal are received and taken into account, a notice of that final determination must be posted in the post office to be closed.

(2) The final determination must contain instructions on how affected customers may appeal that decision to the Postal Rate Commission. Any such appeal must be received by the Commission within 30 days of the posting of the final determination.

123.64 Notice, Public Comment, and Record

123.641 *Posting Proposal and Comment Notice*

A copy of the written proposal and a signed invitation for comments must be posted prominently in each affected post office. The invitation for comments must do the following:

a. Ask interested persons to provide written comments, within 60 days, to a stated address offering specific opinions and information, favorable or unfavorable, on the potential effect of the proposed change on postal services and the community.

b. State that copies of the proposal with attached optional comment forms are available in the affected post offices.

c. Provide a name and telephone number to call for information.

123.642 *Proposal and Comment Notice*

Exhibit 123.642 is a sample format that may be used for the proposal and comment notice (*see page 13*).

123.643 *Other Steps*

In addition to providing notice and inviting comment, the district manager, Customer Service and Sales, must take any other steps necessary to ensure that the persons served by the post office affected understand the nature and implications of the proposed action (e.g., meeting with community groups and following up on comments received that seem to be based on incorrect assumptions or information).

a. If oral contacts develop views or information not previously documented, whether favorable or unfavorable to the proposal, the district manager, Customer Service and Sales, should encourage persons offering the views or information to provide written comments to preserve them for the record.

b. As a factor in making his or her decision, the district manager, Customer Service and Sales, may not rely on communications received from anyone, unless submitted in writing for the record.

(***No active postmaster should play any role in the investigation of a post office for closing or consolidation; neither should an active postmaster be a participant in any decision to close a post office***—Ed.)

123.644 *Record*

The district manager, Customer Service and Sales, must keep as part of the record for his or her consideration and for review by the Chief Marketing Officer and Senior Vice President all the documentation gathered about the proposed change.

a. The record must include all information that the district manager, Customer Service and Sales, considered, and the decision must stand on the record. No information or views submitted by customers may be excluded.

b. The docket number assigned to the proposal must be the ZIP Code of the office proposed for closing or consolidation.

c. The record must include a chronological index in which each document is identified and numbered as filed.

d. As written communications are received in response to the public notice and invitation for comments, they are included in the record.

e. A complete copy of the record must be available for public inspection during normal office hours at the post office proposed for discontinuance or at the post office providing alternative service, if the office to be discontinued was temporarily suspended under 123.7, Emergency Suspension of Service, beginning no later than the date on which notice is posted and extending through the comment period.

f. Copies of documents in the record (except the proposal and comment form) are provided on request and upon payment of fees as listed in *ASM* 352.6.

123.65 Consideration of Public Comments and Final Local Recommendation

123.651 *Analysis of Comments*

After waiting not less than 60 days after notice is posted under 123.641, the district manager, Customer Service and Sales, must prepare an analysis of the public comments received for consideration and inclusion in the record. If possible, comments subsequently received should also be included in the analysis. The analysis should list and briefly describe each point favorable to the proposal and each point unfavorable to the proposal. The analysis should identify, to the extent possible, how many comments support each point listed.

123.652 *Reevaluation of Proposal*

After completing the analysis, the district manager, Customer Service

Postal Service Procedures for Discontinuing a Post Office
– continued –

and Sales, must review the proposal and re-evaluate all the previously made tentative conclusions in light of any additional customer information and views in the record.

a. *Discontinuance Not Warranted.* If the district manager, Customer Service and Sales, decides against the proposed discontinuance, he or she must post, in the post office considered for discontinuance, a notice stating that the proposed closing or consolidation is not warranted.

b. *Discontinuance Warranted.* If the district manager, Customer Service and Sales, decides that the proposed discontinuance is justified, the appropriate sections of the proposal must be revised, taking into account the comments received from the public. After making necessary revisions, the manager must take the following steps:

(1) Forward the revised proposal and the entire record to the Chief Marketing Officer and Senior Vice President for final review.

(2) Attach a certificate that all documents in the record are originals or true and correct copies.

123.66 Postal Service Decision

123.661 *General*

The Chief Marketing Officer and Senior Vice President or a designee must review the proposal of the district manager, Customer Service and Sales. This review and the decision on the proposal must be based on and supported by the record developed by the district manager. The senior vice president can instruct the district manager to provide more information to supplement the record. Each such instruction and the response must be added to the record. The decision on the proposal of the district manager, which must also be added to the record, may approve or disapprove the proposal, or return it for further action as set forth below.

123.662 *Approval*

The Chief Marketing Officer and Senior Vice President or a designee may approve the proposal of the district manager, Customer Service and Sales, with or without further revisions. If approved, the term Final Determination is substituted for Proposal in the title. A copy of the Final Determination must be provided to the district manager. The Final Determination constitutes the Postal Service determination for the purposes of 39 U.S.C. 404(b). The Final Determination must include the following notices:

a. *Supporting Materials.* "Copies of all materials on which this Final Determination is based are available for public inspection at the (name) Post Office during normal office hours."

b. *Appeal Rights.* "This Final Determination to (close) (consolidate) the (name) Post Office may be appealed by any person served by that office to the Postal Rate Commission. Any appeal must be received by the Commission within 30 days of the date this Final Determination was posted. If an appeal is filed, copies of appeal documents prepared by the Postal Rate Commission, or the parties to the appeal, must be made available for public inspection at the (name) Post Office during normal office hours."

123.663 *Disapproval*

The Chief Marketing Officer and Senior Vice President or a designee may disapprove the proposal of the district manager, Customer Service and Sales, and return it and the record to the manager with written reasons for disapproval. The manager must post a notice in each office cited in 123.6 that the proposed closing or consolidation is determined not warranted.

123.664 *Return for Further Action*

The Chief Marketing Officer and Senior Vice President or a designee may return the proposal of the district manager, Customer Service and Sales, with written instructions to give additional consideration to matters in the record, or to obtain additional information. Such instructions must be placed in the record.

123.665 *Public File*

Copies of each Final Determination and each disapproval of a proposal by the district manager, Customer Service and Sales, must be placed on file in the Postal Service Headquarters Library.

123.67 Implementation of Final Determination

123.671 *Notice of Final Determination to Discontinue Post Office*

When giving notice of a Final Determination, the district manager, Customer Service and Sales, must do the following:

a. Provide notice of the Final Determination by posting a copy prominently in the affected post office or offices. The date of posting must be noted on the first page of the posted copy as follows:

"Date of Posting:_____, 19____."

The district manager, Customer Service and Sales, must notify the Chief Marketing Officer and Senior Vice President in writing, of the date of posting.

b. Ensure that a copy of the completed record is available for public inspection during normal business hours at each post office where the Final Determination is posted, for 30 days from the posting date.

c. Provide copies of documents in the record on request and payment of fees under *ASM* 352.6.

123.672 *Implementation of Determinations Not Appealed*

If no appeal is filed pursuant to 39 U.S.C. 404(b)(5), the official closing date of the office must be published in the *Postal Bulletin*, effective the first Saturday 90 days after the Final Determination was posted. A district

(continued on back cover)

UNITED STATES POSTAL SERVICE

Proposal to (Close)(Consolidate) the (Name) Post Office and Optional Comment Form

■

Attached is a proposal that we are considering for providing your community with more economical and efficient postal service, while also providing regular and effective service. Please read the proposal carefully and then let us have your comments and suggestions. If you choose, you may use the form below. Your comments will be carefully considered and will be made part of a public record. If you use the form below and need more space, please attach additional sheets of paper.

Return the completed form to _____ by _____.

In considering this proposal, if you have any questions you want to ask a postal official, you may call _____ whose telephone number is _____.

I. Effect on Your Postal Services

Please describe any favorable or unfavorable effects that you believe the proposal would have on the regularity or effectiveness of your postal service.

_____

_____

_____

II. Effect on Your Community

Please describe any favorable or unfavorable effects that you believe the proposal would have on your community.

_____

_____

_____

III. Other Comments

Please provide any other view or information that you believe the Postal Service should consider in deciding whether to adopt the proposal.

_____

_____

_____

_____

_____

(Signature of Postal Customer) (Date)

_____

(Mailing Address)

_____

(City) (State) (ZIP Code)

Proposal and Comment Notice for Post Office Closing or Consolidation
Exhibit 123.642

The Role of the Postal Rate Commission

Congress has provided, by law, that the Postal Service follow a specific procedure and consider certain factors before making a final determination to close or consolidate a post office.

The law gives any customer the right to appeal the Postal Service's final determination to the Postal Rate Commission (PRC)—an independent agency not associated with the Postal Service. It is the responsibility of the PRC, when a customer appeals a Postal Service final determination, to decide whether the Postal Service's actions were consistent with the law.

The purpose of this section is to help explain the PRC's process in dealing with appeals of Postal Service determinations to close or consolidate post offices.

To assist the PRC in its consideration of the appeal from the Postal Service's decision to close or consolidate a post office, customers should send a written argument explaining why they believe the PRC should revise the Postal Service's determination and return the entire matter to it for further consideration.

Postal Rate Commission Authority

In cases of appeals from Postal Service determinations to close or consolidate post offices, the PRC has only "appellate jurisdiction"—a very limited authority.

One limitation on the PRC's authority is that they cannot conduct their own fact-finding investigation. The PRC must consider appeals based upon the "record" (the proposal, final determination and other documents involved in the decision-making) that the Postal Service collected during the time it was making its decision whether or not to close or consolidate the Post Office. The Postal Service's regulations require that a copy of the record be available at the affected post office for 30 days after the final determination is posted.

The PRC may not return a final determination to the Postal Service merely because the PRC believes a different result might be just as good or better. Rather, the PRC may only examine the Postal Service's decision and record, and decide whether the Postal Service has stayed within the guidelines the law has set up.

Specifically, the law requires that the PRC affirm the Postal Service's final determination unless the determination is:

(a) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;

(b) without observance of procedure required by law, or

(c) unsupported by substantial evidence on the record.

Furthermore, the PRC may not change the Postal Service's final determination. It may only (1) affirm (with the result that the Postal Service's decision will stand), or (2) return the entire matter to the Postal Service for further consideration.

Participant Brief or Statement

The purpose of the brief or participant statement is to point out issues that you believe the PRC should consider in its review of the Postal Service's actions. A customer may choose to file either a participant statement or a formal legal brief. General examples of some issues that would be proper to include would be:

(1) That the Postal Service did not consider certain issues it is required to consider;

(2) The facts upon which the Postal Service is relying have not been established;

(3) The Postal Service did not follow the procedure required by law, and

(4) The facts in the Postal Service's final determination are true, but they do not prove what the Postal Service says they prove.

It is best to be as specific as possible.

In reviewing Postal Service determinations to close or consolidate post offices, the PRC proceedings can be much less formal than is customary in courts. The PRC does not require customers appealing Postal Service decisions to meet the usual requirements as to the form of papers filed, such as typing the documents. No technical formalities are required. A handwritten letter will suffice. However, it is important that papers sent to the PRC be legible. It is also important for statements to be clear and as specific as possible.

Time for Filing Participant Statement

The date a brief or participant statement is due should be posted at the post office slated for closing or consolidation. Customers of the office must, within the first 30 days after the written determination is made available by the Postal Service, appeal the decision to the PRC. Under its rules, the PRC must receive briefs and participant statements within 30 days (rather than receiving briefs that are simply postmarked by that day).

The Appeals Process May Save a Post Office, But Only if Used

By the Hon. Wayne Schley
Former Postal Rate Commissioner

Section 101(b) of Title 39 of the U.S. Code reads as follows:

"The Postal Service shall provide a maximum degree of effective and regular postal service to rural areas, and small towns where post offices are not self-sustaining. *No small post office shall be closed solely for operating at a deficit* (emphasis mine), it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities."

Too often this section of the law governing the U.S. Postal Service has been overlooked or not carried out in the spirit that Congress intended. Consequently, in 1976 Congress added a new responsibility to the Postal Rate Commission (PRC). That new task was the responsibility of serving as an appellate court, so to speak, for those interested citizens who wished to object to any action to close or consolidate their local post office.

The idea was to allow the local citizens to ensure the law was being carried out as Congress intended. Since the PRC accepted this new responsibility, there have been 292 appeals by citizens to stop the taking away of their post offices. Of these, 54 have been remanded, or rejected, and sent back to the Postal Service.

It should be noted, however, that 22 of these rejected cases occurred in the first year when the Postal Service was learning how to go about the process of closing a post office. The agency has learned its lesson well; in the past 19 years, it has lost only 32 cases.

Of the almost 300 cases appealed before the PRC, 66 have been dismissed or withdrawn by the Postal Service. These cases, by and large, were ones so deficient that the Postal Service itself withdrew its efforts to close or consolidate the post offices.

One startling fact should be noted: Less than 8 percent of all post office closings or consolidations are appealed. It is hard to believe that 100 percent of the people in 92 percent of the communities faced with the loss of their post offices do not object. I suspect the real reason for so few appeals is that folks simply do not know that you can fight City Hall, or in this case, the Postal Service. Remember, it is not really so much "fighting City Hall" as it is simply being heard by a disinterested party in order to prevent a federal agency trampling on the rights of postal customers.

The Postal Rate Commission is, indeed, a disinterested third party. It has been said that, if anything, the PRC bends over backwards not to interfere with the Postal Service's management prerogatives in these cases. In fact, the law does not allow the commission to second-guess postal management's decision to close or consolidate a post office. The Postal Rate Commission may only examine the agency's decision and record, and decide whether the Postal Service has stayed within the guidelines the law has established.

The law requires the Postal Rate Commission to approve the Postal Service's decision unless the agency was:

- arbitrary, capricious, indiscreet, or otherwise not in accordance with the law;
- without observance of procedures required by law, or
- unsupported by substantial evidence on the record.

In actuality, the Postal Rate Commission may not change the Postal Service's final decision to close or consolidate an office. It can only affirm, or let stand, the agency's decision, or return (remand) for further consideration (i.e., do it right next time).

Despite all the above, the appeals process is very important in bringing to light the actions of Postal Service management and ensuring they follow not only the letter of the law, but the spirit of the law, as well. Once an issue sees the light of day, minds often can be changed. Elected officials and the public can become involved. Efforts to save a post office can be galvanized.

However, unless the appeals process is used, none of these actions can occur. The key is to use the appeals process the way Congress intended. When 92 percent of the post offices are closed without the appeals process being used, the law is not working the way Congress envisioned.

The challenge—especially to retired Postmasters—is to either use, or urge others to use, the appeals process where warranted. If it is not used, there is no chance to save a post office. The result is a loss not only to the community and the Postal Service—which, after all, loses a retail outlet—but to the nation as a whole.

Postal Service Procedures for Discontinuing a Post Office

– *continued from page 12* –

manager, Customer Service and Sales, may request a different date for official discontinuance when the documents are submitted to the Chief Marketing Officer and Senior Vice President. However, the post office may not be discontinued sooner than 60 days after the posting of the notice required by 123.671.

123.673 *Actions During Appeal*

The procedures for appeal are as follows:

a. *Implementation of Discontinuance.* If an appeal is filed, only the Chief Marketing Officer and Senior Vice President may direct a discontinuance before disposition of the appeal. However, the post office may not be discontinued sooner than 60 days after the posting of notice required by 123.671.

b. *Display of Appeal Documents.* Classification and Customer Service, Postal Service General Counsel must provide the district manager, Customer Service and Sales, with copies of all pleadings, notices, orders, briefs and opinions filed in the appeal proceeding.

(1) The district manager must ensure that copies of all these documents are prominently displayed and available for public inspection in the post office to be discontinued. If that post office has been or is discontinued, the manager must display copies in the affected post offices.

(2) All documents except the Postal Rate Commission's final order and opinion must be displayed until the final order and opinion are issued. The final order and opinion must be displayed for 30 days.

123.674 *Actions Following Appeal Decision*

The procedures following an appeal decision are outlined below.

a. *Determination Affirmed.* If the Commission dismisses the appeal or affirms the Postal Service's determination, the official closing date of the office must be published in the *Postal Bulletin*, effective the first Saturday 90 days after the Commission renders its opinion, if not previously implemented under 123.673a. However, the post office may not be discontinued sooner than 60 days after the posting of the notice required under 123.671.

b. *Determination Returned for Further Consideration.* If the Commission returns the matter for further consideration, the Chief Marketing Officer and Senior Vice President must direct that either (1) notice be provided under 123.663 that the proposed discontinuance is determined not to be warranted or (2) the matter be returned to an appropriate stage under these regulations for further consideration following such instructions as the Chief Marketing Officer and Senior Vice President may provide.

123.7 Emergency Suspension of Service

123.71 *Authority and Conditions*

A district manager, Customer Service and Sales, may suspend the operations of any post office under his or her jurisdiction when an emergency or other conditions require such action. Circumstances that justify a suspension include but are not limited to a natural disaster, the termination of a lease when other adequate quarters are not available, the lack of qualified employees for the office, severe damage to or destruction of the office, and the lack of adequate measures to safeguard the office or its revenue. The district manager must provide written notice of any suspension by FAX to the Chief Marketing Officer and Senior Vice President.

123.72 *Discontinuance of Suspension*

If it is proposed to discontinue a suspended post office rather than restore operations, the procedures outlined in 123.6 must be followed. All notices and other documents required to be posted or kept in the office to be discontinued must be posted or kept in the post office or offices temporarily serving the customers of the suspended post office.

PREPARED BY THE

National Association of Postmasters of the United States

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Mr. OLIHOVIK. Closing small post offices is a dreadful and misguided strategy. Such actions would have a devastating effect on many communities yet have little impact on postal finances. As Robert Cohen of the Postal Rate Commission testified before the Presidential Commission, closing the 10,000 smallest post offices would only net savings of about $567 million, considerably less than 1 percent of the Postal Service's operating budget. The postal network is not merely the sum of its parts, it is an integrated system which relies even on its smallest components. Americans expect access to a full service post office. The Postal Service's own transformation plan recognized this reality. Despite the fact that 70 percent of postal customers are aware that postal products might have been available elsewhere, 80 percent of stamp sales continue to take place at the post office.

It is crucial that the Postal Service have the flexibility to respond to and anticipate customers' needs. In part, the President, his Commission, and legislation considered by the House Government Reform Committee understood the barriers erected by the act. In response, a consensus emerged that endorsed providing the Postal Service with enhanced pricing strategies. Permitting the Postal Service the ability to adjust postage rates within defined limits would be an appropriate mechanism to grant the agency enhanced pricing flexibility.

Postal Headquarters recently put into place a new pay for performance program. This replaced the controversial EVA program. The link between performance incentives and achieving corporate goals reflects the strategy employed by the private sector.

It is important to note that it is difficult to manage a postal facility when performance incentives are inconsistent. The managerial force is compensated using a system that rewards performance. The current salary structure for craft employees does not reward performance. Unless, we are somehow able, through collective bargaining, to create a pay plan that rewards individual or unit achievement, we will miss a crucial opportunity to optimize efficiencies and encourage exemplary performance. In sum, the present pay system compromises the workplace by rewarding one set of employees, yet insulating another. This practice adversely affects morale and performance.

We must also do a better job with our unions to train employees to perform different tasks within the post office. We should work with the crafts to lower or eliminate barriers that preclude postmasters from assigning personnel different duties within a post office. Postal employees should have the flexibility and training to cross over and perform a variety of tasks. I would also suggest that cross training improves job security for those employees whose skills could become obsolete.

Finally, NAPUS remains extremely concerned about the Presidential Commission suggestion to sunset FEHBP and for its coverage of the postal employees. The proposal would subject health and retirement benefits to collective bargaining. My two primary concerns with the proposal are that it does not address the impact upon current and future postal retirees and it ignores the effect that separating postal employees from the health and retirement programs would have on the entire Federal benefits program.

Mr. Chairman, this concludes my remarks. I look forward to working with you and other members of this panel as we strive to ensure that the Postal Service will prosper for many years to come.

Mr. MCHUGH. Thank you, very much, Wally. Appreciate your effort to be here and your continued support and interest in this process.

Next, as I have introduced previously, Mr. Steve LeNoir, who is president of the League of Postmasters. Steve, thanks.

[The prepared statement of Mr. Olihovik follows:]

National Association of Postmasters of the United States

Testimony of

Walter M. Olihovik

National President

Before the

House Government Reform Committee

Special Panel on Postal Reform and Oversight

February 5, 2004

Mr. Chairman and distinguished Members of the Committee, on behalf for the 42,000 members of the National Association of Postmasters of the United States (NAPUS), I welcome the opportunity to share with you my thoughts regarding the need to update the Postal Reorganization Act of 1970. Indeed, our nation's postmasters hail the extraordinary endurance and diligence with which you, Chairman McHugh, Ranking Member Davis, and other congressional stalwarts have promoted responsible and much-needed postal modernization.

I would be remiss if I did not publicly thank you, Mr. Chairman, and Mr. Davis for your stewardship of the Postmaster Equity Act last year. With its enactment, the 27,000 postmasters have a new and hopefully effective tool to provide the managers-in-charge of post offices a fair process for discussion of some of the most complex issues confronting postmasters and Postal Headquarters.

As you are aware, the postal reform odyssey began in 1995. NAPUS was there then and remains in the forefront of ensuring that there will be a viable Postal Service for many years to come. We are cautiously optimistic that with the aggressive support of the Bush Administration and bipartisan cooperation by Members of Congress, the eight-year legislative journey may yield its first fruits this year.

The Postal Service's importance to our national economy cannot be overstated. The statistics bear repeating – the Postal Service is the heart of a 9 billion industry, employing 9 million workers, and accounting for approximately 9 percent of the country's Gross

Domestic Product (GDP). A sick Postal Service infects a significant portion of the U.S. economy. What we also know to be true is that economic uncertainty and a national financial slow-down has major ramifications for the Postal Service. The consistent erosion of first-class mail – even in times of plenty – is an ominous sign for the Postal Service. During the third quarter of the last year, the GDP rose by an impressive eight percent. Yet, the Postal Service projects a 3.2 percent drop in first-class mail volume. Moreover, first-class mail volume flattened-out or slumped even before the 2001 downturn in the U.S. economy.

It is true that Standard Mail has helped to shore up total mail volume, but the infrastructure upon which universal service relies cannot live by standard mail alone. Exponentially increasing delivery points combined with meeting long-ignored capital needs demand attention. The Postal Service requires enhanced opportunities to boost revenue and greater flexibility to meet the needs of postal customers.

As you know, this Committee assisted the Postal Service, if only temporarily, by passing Public Law 108-18. The Civil Service Retirement System recalculation legislation provided a short reprieve. It was not a permanent solution. As part of your efforts to reform the Postal Service, Congress needs to revisit the pension issue in order to reverse the decision to shift the military retirement liability onto the Postal Service, and to permit the Postal Service to use the escrow that will accrue as the result of the CSRS recalculation. The military retirement modification shifted a $27 billion obligation from the federal government to the Postal Service. The President's Postal Commission

recommended that this obligation return to the government. These much-needed funds could be used to pre-fund retiree health obligations. Eliminating the escrow account would reduce the need for a postage rate spike in 2006. NAPUS also believes that such funds could be invested in postal infrastructure that has been ignored for some time. It is important to repeat the fact that remedial CSRS legislation will not in and of itself provide the Postal Service with long-term relief. Over the last two years, the Postal Service has successfully reduced costs to balance shrinking revenue. This has resulted in more optimistic than anticipated bottom lines. However, the Postal Service cannot continue to chip away at costs without influencing the quality of mail service that Americans expect and demand. Rather, we need the tools and flexibility that are essential to grow revenue. A more comprehensive approach is necessary which addresses the operational, regulatory, and financial needs of the Postal Service.

Mr. Chairman, these demands can be best met by legislative change akin to legislation which you, Representative Davis and others have promoted in the past. The time to act is now. It will be too late when we are sorting through the pieces of the Postal Service and attempting to apply band-aids to a mortally wounded patient. President Bush has emerged as a strong ally in your effort to push forward. The five principles that the Administration announced in early December reflect and reaffirm your ongoing legislative efforts. We agree that legislation should encourage the implementation of the best practices, ensure financial and operational transparency, enhance managerial flexibility to adjust rates, promote accountability, and ensure self-financing. NAPUS continues to associate itself with Congressional and Administration efforts and will advance these efforts.

The fundamental mission of the Postal Service remains unchallenged. The institution performs an inherently governmental function and it should continue to provide affordable universal postal services. Universal means everywhere, everyday, to everyone – rural, suburban, and urban settings. This policy matter Congress must reserve to itself and not delegate to a postal regulator.

Universal service encompasses a nationwide retail and delivery network that reaches into every city and town. There are currently approximately 27,000 full service post offices in the nation and 11,000 subsidiary postal facilities. Historically, there were many more post offices. However, during the past century, a large number of post offices were closed or suspended. In fact, over the past forty years, more than 14,000 post offices have been either closed or suspended. It is clear that, under current law and postal regulations, the Postal may, and in fact does close post offices. This authority is not to be taken lightly, since countless communities rely on their post office for basic mail operations. For this reason, section 404 of Title 39 affords communities of specific due process rights should the Postal Service target their post office for closure. NAPUS urges Congress to reject attempts to weaken these rights afforded to American communities. In many situations, this is the only opportunity for communities to appeal post office closures.

NAPUS has worked with communities in safeguarding their legal rights to protect their local post office. Many years ago, NAPUS created the Post Office Closing and Consolidation Committee, which monitors Postal Service proposals to close post offices

and ensures that appropriate local officials understand their rights under the law. As part of this effort, NAPUS publishes and circulates *The Red Book: a NAPUS Action Guide for Preventing the Closing and Consolidation of Your Post Office*. In addition, NAPUS has worked closely with the Congressional Rural Caucus to safeguard a community's due process rights.

Closing small post offices is a dreadful and misguided strategy. Such actions would have a devastating effect on many communities, yet have little impact on postal finances. As Robert Cohen of the Postal Rate Commission testified before the Presidential Commission, closing the 10,000 smallest post offices would only net savings of about $567 million – considerably less than 1 percent of the Postal Service's operating budget. The postal network is not merely the sum of its parts; it is an integrated system, which relies even on its smallest components.

The growing number of delivery points, approximately 1.7 million per year, cries out for more post offices that are strategically located to help guarantee the reliability and universality that are the essential to a viable Postal Service. Americans expect access to a full service post office. The Postal Service's own Transformation Plan recognized this reality. Despite the fact that 70 percent of postal customers were aware that postal products might have been available elsewhere, 80 percent of stamp sales continue to take place at the post office. Moreover, the President's postal panel commissioned a poll, which found that 72 percent of those surveyed were either extremely satisfied or quite satisfied with service provided by their local post office.

It is crucial that Postal Service have the flexibility to respond to and anticipate customer needs. The U.S. economy rewards dynamic organizations and penalizes those that are incapable of adapting to new market realities. The Postal Reorganization Act did not envision the advent of the digital age and keen competition, both domestic and foreign. Therefore, the thirty-three year old Act saddled the Postal Service with regulatory burdens and rigid rules that preclude a fair opportunity for it to participate successfully in the postal market. In part, the President, his Commission, and legislation considered by the House Government Reform Committee understood the barriers erected by the Act. In response, a consensus emerged that endorsed providing the Postal Service with enhanced pricing strategies, in order to be a nimble player in a highly competitive communications and logistics market. Permitting the Postal Service the ability to adjust postage rates within defined limits would be an appropriate mechanism to grant the agency enhanced pricing flexibility. Moreover, permitting the Postal Service greater opportunities to negotiate with customers over rates would also be a major improvement over the present convoluted postal rate-setting regimen.

The President's Commission on the Postal Service made a number of recommendations relating to the collective-bargaining process with its unions. While NAPUS takes no position on the merits of the recommendation, we are conscience of the controversy surrounding the issue. Nonetheless, I would like to address two of the recommendations. As you may know, postmasters, supervisors and Postal Headquarters recently put into place a new pay-for-performance program. This replaced the controversial EVA program.

The link between performance incentives and achieving corporate goals reflects a strategy employed by the private sector.

It is important to note that it is difficult to manage a postal facility when performance incentives are inconsistent. The managerial force is compensated using a system that rewards performance. The current salary structure for craft employees insulates them from performance. Students of modern management recognize the concept of deviation in workplace performance. Different employees, as the result of different skills and aptitudes, function differently. Unless we are somehow able, through collective bargaining, to create a pay plan that rewards individual or unit achievement, we will miss a crucial opportunity to optimize efficiencies and encourage exemplary performance. In sum, the present pay system compromises the workplace by rewarding and potentially penalizing one set of employees, yet insulating another.

We also need to do better job with our unions to train employees to perform different tasks within the post offices. This would enable the offices to be more agile and to adapt successfully to customer needs. We should work with the crafts to lower or eliminate the barriers that preclude postmasters from assigning personnel different duties within a post office. If long lines are developing in a postal lobby, the postmaster should be able to reassign temporarily an employee from sorting mail in the backroom to working a retail window. Postal employees should have the flexibility and training to cross over and perform a variety of tasks.

Finally, NAPUS remains extremely concerned about the Presidential Commission suggestion to "sunset" Federal Employees Health Benefits Program and Federal Employee Retirement System coverage of postal employees. The proposal would subject health and retirement benefits to collective bargaining. My concerns are: one, the proposal does not address the process by which postal managers would earn their benefits. Two, the proposal does not address the impact upon current and future postal retirees. Three, it is unclear how existing and prospective postal liabilities and assets within the FEHBP Trust Fund would be treated. And, fourth, the proposal ignores the effect that separating postal employees from the health and retirement programs would have on the entire federal workforce and its retirees.

Mr. Chairman, this concludes my remarks. I look forward to working with you and other Members of this panel as we strive to ensure that Postal Service will thrive for many years to come.

Mr. LENOIR. Thank you, Mr. Chairman and members of the special panel. Thank you for inviting me to appear before you today. My name is Steve LeNoir and I am the president of the National League of Postmasters. Before coming to Washington, DC, I served as postmaster in Horatio, SC for the last 23 years. And while you say Pierrepont Manor has a population of 214, my community has well over 1,000 citizens in it.

Mr. MCHUGH. Actually, to be honest, 213, because I am out of town today.

Mr. LENOIR. Chairman McHugh, I want to publicly thank you for your efforts over the last decade on the behalf of the Postal Service, and we look forward to working with you and your committee. And Congressman Davis, we thank you for hosting this hearing.

I welcome the opportunity to discuss the important issue of postal reform. Started in 1887 to represent rural postmasters and formally organized in 1904, the National League of Postmasters is a management association representing the interests of all postmasters. Although we represent postmasters from all across the country, from the very largest to the smallest post offices, rural postmasters are a sizable portion of our membership. The League speaks for thousands of retired postmasters as well. Mr. Chairman, we would like to thank you and your colleagues on the Government Reform Committee for your dedication to the issue of postal reform.

Postal reform is critical to the long term ability of the Postal Service to provide affordable universal mail service to every individual, home, and business in America. There is no doubt that the Postal Service needs fundamental change. We know that our jobs and those of the people we manage are ultimately at stake. While we know that the Postal Service's transformation plan takes us in the right direction, we also know that legislative reform is necessary to finish the process. We commit ourselves to work with you to make this a reality.

Mr. Chairman, as Congressman Davis stated in his opening remarks, the most critical issue facing the Postal Service now is the civil service retirement issue. Last year's legislation corrected an overpayment to the CSRS that saved the Postal Service billions of dollars, but put those savings from 2006 on into an escrow account. The Postal Service has suggested using it to pre-fund retirees' benefits, thus funding one of the biggest unfunded liabilities that the Postal Service would face in the future. We think this is an excellent idea.

Also, last year CSRS legislation forced the Postal Service to assume the responsibility for $27 billion in military retirement benefits that were earned by postal employees before joining the Postal Service. That responsibility is not one that the Postal Service should bear, and it deserves to be transferred back to the Treasury. We strongly urge Congress and the committee to make both of these issues a top priority.

On December 8th of last year, the Bush administration called on Congress to enact postal reform and listed five principles that it believes should guide postal reform. We believe these five principles are an excellent foundation for postal reform.

One issue that does concern us is the possibility of closing rural post offices. The League is concerned that access to a post office in

a rural community could dramatically change if postal reform is not implemented properly. We are particularly concerned that overzealous individuals could develop a mistaken belief that closing small post offices would net meaningful savings for the Postal Service. As my colleague, President Wally, pointed out, the facts do not support that. The record shows that the cost of the 10,000 smallest post offices is less than 1 percent of the total budget for the Postal Service.

Mr. Chairman, rural post offices are a key to a healthy rural economy and are necessary to provide a universal service in rural America. As supported by our written testimony, the local post office is an American institution that literally binds rural America together politically, socially, and economically. It is the lifeblood of rural communities and it should not be harmed.

No less important are small post offices in inner city areas. They provide a vital link to the Postal Service and the country and they also should not be harmed. While we understand there may be a legitimate reason to close a post office, we do not believe that the existing rules pertaining to these closings of post offices should be changed. These rules are fair to the customers, the local community and the Postal Service.

The League of Postmasters looks forward to working with you and your committee in passing responsible postal reform and we pledge ourselves to that effort. And I would be happy to answer any questions the committee may have.

[The prepared statement of Mr. Lenior follows:]

Testimony of Steve D. Lenoir

President of the League of Postmasters

Before the Committee on Government Reform

of the

United States House Representatives

Chicago, Illinois

February 5, 2004

TESTIMONY OF STEVE LENOIR
OF THE NATIONAL LEAGUE OF POSTMASTERS
Chicago, Illinois, February 5, 2004

Mr. Chairman, members of the Committee, thank you for inviting us to appear before you today. My name is Steve LeNoir and I am the President of the National League of Postmasters. I have been President of the LEAGUE since 2002, and have served in state, regional, and national positions since 1982. I welcome this opportunity to discuss the important issue of postal reform.

Postal Reform is critical to continue the long-term ability of the United States Postal Service to provide affordable, universal mail service to every individual, home, and business in America. There is no doubt that the Postal Service needs fundamental change. We know that our jobs—and those of the people we manage—are ultimately at stake.

While we know that the Postal Service's Transformation Plan takes us in the right direction, we also know that fundamental legislative reform is necessary to finish the process, and to ensure that the Postal Service remains healthy and strong. We pledge to see that that reform is enacted.

Last year you passed the Civil Service Retirement System (CSRS) legislation that reformed pension funding and corrected an overpayment to CSRS that saved the Postal Service billions of dollars. We thank you for your efforts in getting that through Congress so quickly. But the issues surrounding the postal "escrow" and the $27 billion in military retirement benefits earned by postal employees for service before joining the

Postal Service needs to be addressed. We strongly urge Congress to make this a top priority.

Background

Started in 1887 to represent rural postmasters, and formally organized in 1904, the National League of Postmasters is a management association representing the interests of all Postmasters. Although we represent postmasters from all across the country—from the very smallest to the very largest Post Offices—rural Postmasters are a sizable portion of our membership. The LEAGUE speaks for thousands of retired Postmasters as well.

On a personal note, I am from Horatio, South Carolina, and have been postmaster there since 1981. Currently, I am on leave from my postmaster position to serve with the LEAGUE here in Washington.

Mr. Chairman, I come from an old postal family and when I speak of the Postal Service, I speak from a century-old tradition. My wife is a postmaster in South Carolina and she was a postmaster in West Virginia before that. My mother was a Postmaster for 32 years, and the type of dedicated person that worked in the Post Office right up until the day I was born. My great grandfather, Walter LeNoir, was the Postmaster in Horatio from 1900 to 1935.

We grew up in an environment where the Postal Service was revered. I can still remember my mother sitting at the kitchen table and coaching me to study for the postal exam. She did this because she saw a bright future for the Postal Service. Although we've seen many changes in society and the Postal Service since the 1970 Postal Reorganization Act, I believe that with proper legislative reform, we can still have a bright future and be a viable entity for decades to come.

Postal Reform Is Needed

The recent Report of the President's Commission on the Postal Service concluded "if the nation embraces an ambitious modernization, then the Commission is very confident that the Postal Service can continue its 225-year tradition of innovation and adaptation to remain a valued and relevant enterprise to the nation it exists to serve." Commission Report at iii. We agree with those sentiments. The Commission also found, however, that the Postal Service is in "significant jeopardy" and that without "fundamental reforms, the risk of a significant taxpayer bailout or dramatic postage rate increases looms large." We agree with that assessment as well. Postal Reform is an absolute necessity if the Postal Service is to thrive in the 21st century.

On December 8th of last year, the Bush Administration called on Congress to enact postal reform and listed five principles that it believes should guide Postal Reform: Create Greater Flexibility, Remain Self Financing, Ensure Financial Transparency; Ensure Accountability; and Implement Best Practices. We believe these five principles are an excellent foundation for postal reform and later in this testimony we give our view of what we see these five principles encompassing. Before that, however, we would like to address an issue of critical importance to the LEAGUE: the cost, profitability, and relationship of rural Post Offices and Universal Service to America.

The Cost of Small Post Offices Is Less Than One Percent of the Postal Service's Budget

The League is concerned that access to a Post Office in a rural community could dramatically change if postal reform is not implemented properly. We are particularly concerned that overzealous individuals could develop a mistaken belief that closing small Post Offices would net meaningful savings for the Postal Service. That simply is not

true. As the Postal Rate Commission's Robert Cohen pointed out, the cost of the 10,000 smallest Post Offices is less than one percent (1%) of the total budget of the Postal Service. Testimony of Robert Cohen before the President's Commission on the Postal Service, February 20, 2003 at 2, 9-10.

Whether Rural and Inner City Post Offices Are Profitable Depends Upon Postal Accounting of Revenues and Costs

There is a widespread misconception that many rural and inner city Post Offices are not profitable, and that more than half of the Post Offices do not break even. This is not an accurate picture of the situation because none of the revenue from a piece of mail is credited to the Post Office where the mail is delivered.

For instance, Carolina Power & Light serves a two-state area and mails electric bills all across North and South Carolina, including hundreds of rural and inner city Post Offices. All the revenue from a Carolina Power & Light mailing is credited to one Post Office in Raleigh, North Carolina. None of it is credited to the hundreds of Post Offices that actually deliver the bills. Clearly it is wrong to say that the Raleigh Post Office is profitable in regards to this mailing simply because it is credited with all the revenue, and to say that the smaller delivery Post Offices are not profitable simply because they are credited with no revenue but have to bear the costs. This is a major mismatch of revenues and costs, which results in a distorted picture of which Post Offices are "profitable" and which are "not profitable."

Post Offices Are Necessary To Provide Universal Service in Rural America

In the LEAGUE's testimony before the President's Commission on the Postal Service we argued—as many others did—that Universal Mail Service was still needed. We were very pleased to see that the first lines of the Commission's Report reaffirmed that view: "Universal postal service remains vital to the nation and its economy at the dawn of the 21st century." Commission Report at vii.

Yet the Commission did not define Universal Service, and we know of no clear definition of Universal Service. As we read it, the question remains open as to what constitutes Universal Service.

The League believes that providing Universal Service means not only providing universal mail delivery to all citizens, but also providing equal access to all postal services, including Post Offices. The Postal Service has an obligation to provide quality postal services and access to Post Offices on a universal basis, regardless of whether a Post Office is "profitable." This is particularly true in rural America where Post Offices play a role that go far beyond providing postal services.

The local Post Office is an American institution that is critical to the well-being of rural America. It should not be harmed, for it is the institution that literally binds rural America together, politically, socially, and economically. It is the lifeblood of rural communities.

The older rural population lives by their day-to-day interaction at the Post Office, as well as by delivery of many important things such as medication. It is a big deal when the mail arrives at a local Post Office, and often many are there to greet it. Rural 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.

Rural Post Offices also 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. For decades Post Offices have been gathering places where friends share news of graduations, birthdays, and marriages. Neighbors would wait for letters from sons and daughters away at college or serving in the Armed Forces. Rural Post Offices have also provided safe havens for children as school bus stops.

Many rural Postmasters provide services that go above and beyond the call of duty. Postmasters help address envelopes for their patrons, as well as read and explain mail to them. For instance, I used to help customers that didn't have educational opportunities fill out money orders, write checks, and write correspondence. Additionally, state and federal forms are available in post office lobbies, and rural Postmasters often help local citizens with these. Local Post Offices also provide community bulletin boards and post federal notices. These are critical services to the rural community.

Even if closing rural Post Offices did save sizeable amounts of money, and even if postal accounting did appropriately credit revenues to Post Offices of delivery, we believe Post Offices must be measured by the service they provide to the entire nation and not be judged solely on financial considerations. The local Post Office is an icon of rural America, and neither Congress nor the Postal Service should tamper with it, for once a town's Post Office disappears, the town often shrivels up and dies.

We were pleased to see that the President's Commission agrees with us: "'low-activity' Post Offices that continue to be necessary for the fulfillment of the Postal Service's universal service obligation should not be closed, even if they operate at a substantial economic loss." Commission Report at XIV (italics in original).

We urge the Committee to see that a definition of Universal Service in any postal reform bill makes it clear that Post Offices are necessary to fulfill the Universal Service mandate, particularly in rural areas, where Post Offices play such a critical role.

Keep the Current Post Office Closing Rules

While we understand there are legitimate reasons to close a Post Office, we do not believe that the existing rules pertaining to the discontinuance of Post Offices should be changed or modified. These rules are fair to customers, local communities, and to the management of the Postal Service. While we do not believe that the current Postmaster General and Headquarters staff have a hidden agenda on Post Office closings, we cannot be assured that future leadership will have that same philosophy or the same sensitivity to the needs and interests of the local community, if the law were relaxed.

The Administration's Five Principles for Postal Reform

1. **Flexibility.** The key to the future of the Postal Service is introducing more flexibility into the system on a wide variety of fronts.

Pricing and Product Flexibility. While we accept the fact that some sort of pricing regulation is necessary for a monopoly, the present system is simply too burdensome. The Pricing system has to be made simpler, and the process faster.

Flexibility to Close Post Offices. We discussed this extensively above and feel current law is sufficient.

Flexibility to Close Mail Processing Facilities. The ability to close mail processing facilities is markedly different from the issue of closing small Post Offices. In November of 2003, Senators Collins and Carper sent Postmaster General Jack Potter a letter requesting information on the Postal Service's plans in this area by April 7, 2004:

> You testified that the Postal Service must have the ability to alter its retail and mail processing networks to meet customer needs, provide increased access, and achieve greater operational efficiency. In this regard, the Service's Transformation Plan noted that the Service plans to optimize its retail network, including closing retail facilities deemed to be redundant and reducing the Service's physical infrastructure in markets where the Postal Service considers its retail access to be over represented. . . . we would like for you to provide the Committee with a plan that lays out how the Postal Service intends to optimize its infrastructure and workforce. The plan should describe the criteria, process, and data the Service uses to make its decisions, as well as the parties consulted in the plan's development."

The LEAGUE is waiting to hear how the Postal Service addresses this issue before we comment further.

Flexibility to Sell Services and Products. We agree with the Commission's recommendation to make postal services, such as stamps and service kiosks, more convenient for customers and to take some of that activity out of Post Offices. But, there's an important fact to note—there are two different retail markets and we should not have a one-size-fits-all mentality.

One market is that of the large Post Offices, whose long lines are a detriment to service. Those Post Offices can benefit by providing more basic service outlets in the area, outside of the Post Office. However, in medium to small Post Offices, where lines are not an issue, we see a big benefit in having customers transact business in our postal lobbies. That gives us a chance to up sell postal products in addition to offering other services.

The Presidential Commission suggests that we move postal retail to Wal-Marts and other such large retail outlets. While that may make good business sense in large retail markets where lines are an issue, I believe it would be short sighted not to use our lobbies in medium to smaller Post Offices to their full benefit. When customers enter our lobbies, we have a chance to up-sell postal products. We should take advantage of that opportunity.

2. Self-Financing. We agree with President Bush that the Postal Service should be self-financed. We take pride in the fact that we have not received tax support since 1982. Our commitment to the Transformation Plan has proven that we are committed to continued cost reduction, increasing revenue, and postal self-sufficiency.

One way to help the Postal Service continue its self-sufficiency is to maximize the revenue potential of the nation's Post Offices. While delivery of letters, periodicals, advertising mail, and parcels is our core business, we feel there is so much more we can do. Our network of Post Offices provides a unique opportunity to expand non-postal services at our facilities while utilizing the infrastructure we have. We take pride in serving our customers, and we need to realize our full potential.

Over seven million customers visit our lobbies each business day. By offering appropriate products and services we can serve our customers and improve the Postal Service's bottom line. We believe that there is great value in our network of over 26,000 post offices and we have not fully maximized that value.

We hasten to point out that we are not suggesting that the Postal Service should enter into competition with the private sector. Rather, we are suggesting that in rural areas where the private sector does not provide adequate services, the Postal Service

could fill that gap. For instance, in my city of Horatio, I added a fax and copy machine to my Post Office because the closest photocopying shop was 20 miles away. That served our citizens well, had no effect on the private sector, and has paid for itself many times over.

Ideas for Partnering with the Private Sector. The LEAGUE has been working with Postal Headquarters to explore revenue-producing ideas, and has also been soliciting ideas from our Postmasters over the past year. The ideas I am presenting you with today can enhance the role the Postal Service plays throughout America. This can be done in many instances through partnerships with local businesses as well as in government-related services.

Let's look at some ideas for partnering with the Private Sector:

• Computers for access to the Internet and e-mail could be provided in rural and inner-city Post Office lobbies.

• ATM machines from area banking establishments could be installed in "unbanked communities."

• Coupons and advertising could be sold on the backside of postal receipts as many grocery stores do today.

• Fax and copy services could be offered in communities which currently don't offer that service.

Ideas for Partnering with the Local, State, and Federal Government. Another huge opportunity I see for the Postal Service is working with local, state, and federal governments. Currently, Post Offices serve as a resource to the Federal government by providing IRS tax forms, registration for Selective Service, wanted posters for the FBI, and Duck Stamp sales for the Department of the Interior. We could do more of that:

• Voter Registration. We could offer voter registration at post offices, making it easier for citizens to participate in the democratic process.

• Medicare/ Medicaid assistance. We could designate selected Post Offices, especially in rural America, as administering offices for the Medicare/Medicaid program. These offices could maintain a supply of equipment used by Medicare patients.

• Prescription drug delivery. We could also help with prescription drug delivery in rural areas. Holding the medicine for pickup at the Post Office could prevent its exposure to adverse weather conditions. Numerous customers in rural America receive prescriptions through the mail because there are no pharmacies nearby.

• We could also play a significant role in gathering census data in rural areas.

• We could serve the new Homeland Security Agency (HSA) as information centers, meeting places, storage centers for emergency items, or however deemed necessary by HSA. We currently have HAS information in our postal lobbies, but there is an even greater role that we could be playing.

These are just a few examples, and I am sure that with creative thinking we can come up with more possibilities to partner with government and private industry.

3. **Transparency.** The President's Commission on the United States Postal Service stated that the Postal Service should set the standard for financial transparency by which all other federal entities are judged. Commission Report at 66. In furtherance of this goal, the Commission recommended that the Postal Service voluntarily comply with applicable provisions of the major Securities and Exchange Commission (SEC) reporting requirements. Commission Report at 66.

I believe we can do this and that the Board of Governors has already started along this path. At the January 2004 Board of Governors meeting, Chairman David Fineman, said:

> I am pleased to report that significant progress has been made. The 2003 Annual Report, which is posted on our Web site, includes enhanced disclosures in the footnotes and the Management Discussion and Analysis section. Also, in the First Quarter of Fiscal Year 2004, the Postal Service has begun to publicly report significant events, on our web site, in accordance with SEC Form 8-K reporting requirements. Additional progress will be achieved with the issuance of the Quarter 1, Fiscal Year 2004 Financial Report in February. Consistent with SEC Form 10-Q, this report will include an enhanced Management Discussion and Analysis section and expanded financial statements. . . . In the coming months we will complete plans to further enhance our annual financial reporting.

We believe that the Postal Service is well on its way towards achieving this goal.

4. **Accountability.** The Postal Service has certain monopoly products, and we understand that monopolies cannot have complete pricing freedom. The LEAGUE accepts that principle and understands that appropriate oversight is vital to the future health and well-being of Universal Mail Service and consumer welfare. The President's Commission recommended a three-person board that would have the power to identify the scope of Universal Service and regulate the products and services we offer. We oppose the idea of giving that much authority to three individuals.

5. **Implement Best Practices.** The LEAGUE believes that the current structure of the Board of Governors functions well. However, everything can always be improved, and the LEAGUE would support any measures that ensured the Postal Service's governing body was better equipped to meet the responsibilities and objectives of an enterprise of the size and complexity of the Postal Service.

CONCLUSION

At the beginning of the 21st century, rural America contains 80 percent of the nation's land, is home to 56 million people, and has a poverty level higher than urban America, according to the Department of Agriculture's Economic Research Service. www.ers.udaa.gov. We believe Post Offices fulfill a need for this segment of the population by providing invaluable service that cannot be measured in dollars. We believe Post Offices must be measured by the service they provide, and not be judged solely on financial considerations of the Postal Service. The total cost of rural Post Offices is less than one percent of the Postal Service's Budget. Post Offices are critical to rural America and their role goes far beyond a postal function.

Let's work to make Post Offices not only a lifeline to customers but also a positive link to government at all levels. We think there is great value in our network of Post Offices.

The American flag is raised at by Post Offices every day, all across this country. The tradition of the Postmaster—starting with Ben Franklin in colonial times—is connected to many freedoms enjoyed through the Constitution of the United States and the Bill of Rights. It supports and enables many of the rights given to us. Universal Service is important to all citizens, all Americans, in the equal opportunity it provides.

On behalf of the National League of Postmasters, I want to thank you for this opportunity to appear before you today. We look forward to working with Congress and this Committee to ensure that we pass responsible postal reform that will benefit the Postal Service and the customers we serve.

Mr. MCHUGH. Thank you very much, Steve. Let me ask you a question. It has nothing to do with postal reform, but what is the name of the post office, in Horatio?

Mr. LENOIR. It is the Horatio Post Office.

Mr. MCHUGH. What is the name of your Member of Congress, and I do not mean to embarrass you, if you do not know?

Mr. LENOIR. John Spratt and also Jim Clyburn, I am right on the line between those two.

Mr. MCHUGH. Well, the reason I ask, the folks in the audience do not have the benefit of the written testimony I do not believe, maybe they do. They do not have the benefit of the written testimony, just in case you think this gentleman's association with the post office is tenuous, according to his written testimony, he comes from an old postal family, "when I speak of the Postal Service, I speak from a century old tradition." Steve's wife is a postmaster in South Carolina and she was a postmaster in West Virginia before that. His mother was a postmaster for 32 years, and as he absolutely correctly noted, the type of dedicated person that worked in the Post Office right until the day he was born. And his great-grandfather, Walter LeNoir, was Postmaster in Horatio, where he has been Postmaster since, what 1981?

Mr. LENOIR. 1900–1935.

Mr. MCHUGH. His, I mean you, the same post office.

Mr. LENOIR. Yes, I have been there since 1981.

Mr. MCHUGH. If we do not name this one the LeNoir Post Office, there is something wrong. We will have to talk about that. In any event, thank you very much, sir.

It hasn't been since 1900 that Vince Palladino has been in his esteemed position, but when I began this process and had the honor of serving as the chairman of the Postal Subcommittee, in my second term in the House of Representatives, Vince Palladino at that time was president of the National Association of Postal Supervisors, and it is a comfort to me and I am sure to his many members that he remains the president. So, Vince, it is good to see you again; welcome, and as always we look forward to your comments.

Mr. PALLADINO. Thank you very much, Chairman McHugh. I have reduced my remarks due to the pending storm, possibility of fire or other hazards. [Laughter.]

Thank you, Chairman McHugh, for the opportunity to appear before the Special Panel on Postal Reform and Oversight on behalf of the 36,000 postal supervisors, managers and postmasters who belong to the National Association of Postal Supervisors. I am pleased to be here today to participate in this hearing to add our voice in support of congressional passage of comprehensive postal reform. This hearing is an important step toward the achievable goal of passing a postal reform bill this year.

My testimony today is devoted to four areas that should be embraced by postal reform: rationalizing the postal network, achieving effective labor-management relations, improving pay and performance incentives, and postal pension funding reform.

We agree with the Postal Commission that the current network of post offices and plants requires streamlining, leading to the closure of unneeded facilities, to assure that universal service is deliv-

ered in the most effective and cost-efficient manner possible. Indeed, many of the Nation's post offices are probably no longer necessary to fulfill the universal service obligation.

Streamlining or rationalizing of the postal network should be carried out on a comprehensive basis under the authority and the control of the Postal Service, in consultation with Congress and its stakeholders. The ultimate aim should be to arrive at cost savings while preserving affordable universal service.

We see no need for the establishment of a Postal Network Optimization Commission [PNOC], as recommended by the President's Commission, applying a base closing approach to unneeded postal facilities. The Postal Service is the best-equipped entity to arrive at the optimal number, location and function for the mail processing and distribution functions, just as the Postal Service is similarly equipped to arrive at the optimal number, location and function for post offices.

Under current law, the Postal Service is not allowed to close post offices for economic reasons alone. The Commission recommended that such statutory restrictions be repealed and that the Service be allowed to close post offices that are no longer necessary for the fulfillment of universal service. We agree and urge the Congress to grant the Postal Service the flexibility and necessary accountability in fair and rational ways to fulfill its universal service obligation in a cost efficient and effective manner.

From my perspective, as president of one of the foremost management associations within the Postal Service, progress is being achieved in fostering better communication at the national level between the Postal Service and the leadership of the craft unions and the management associations. However, progress in lower levels and in other areas continues to remain uneven, especially in the resolution of grievances.

The Postal Commission noted that "Encouraging progress is being made by the Postal Service and one of its unions in resolving grievances through the use of a streamlined grievance process involving a Dispute Resolution Team [DRT], comprised of representatives of management and the craft. We believe the DRT approach is best directed to the resolution of contract-related disputes in the field where they begin, while workplace environment disputes are best resolved by mediation. We also are concerned by the growing reliance by DRT upon non-binding arbitration decisions as precedent by Dispute Resolution Teams. We encourage the panel to continue its oversight in these endeavors.

Recently, the National Association of Postal Supervisors and postmaster organizations have collaborated with the Postal Service in establishing a new pay for performance system, reshaping the EVA system first established in 1995, that better rewards teamwork, efficiency, and service quality in a fair manner. Measurable and realistic goals are now being established at the unit, district and area levels as part of the new system; progress is being made. We agree with the Commission that it is time to expand merit-based pay to the entirety of the postal work force, including bargaining unit employees. The establishment of an incentive-based culture of excellence in any organization relies upon performance

management systems that reach across the entire organization and cover all employees, not only those in management ranks.

The Commission urged the Postal Service to undertake a study of performance-based compensation programs for both management and union employees and work with the unions and management associations to design and implement a performance-based compensation program. We are counting on the Postmaster General and the craft unions to negotiate some form of pay for performance at the bargaining table. We also urge Congress to repeal the current statutory salary cap as it applies to the Postal Service—currently $171,900—and that the Postal Service be authorized to establish rates of pay for top Postal Service officers and employees that are competitive with the private sector. Additionally, we encourage the special panel to take a critical view toward the necessity of establishing a new regulatory body, such as the Postal Regulatory Board, to assume authority over total compensation, scope of the monopoly, definition of universal service, as well as other important policy and regulatory powers exercised by Congress, the Postal Rate Commission, and the Postal Service itself.

Similarly, we question the wisdom of subjecting Postal Service pension and post-retirement health benefits to collective bargaining. This could significantly impact the vitality of the entire Federal pension and retiree health benefit programs, and we caution Congress to move very carefully in full consultation with the postal stakeholder community before proceeding in these areas. We support the Postal Service's proposal to eliminate the escrow requirements so the Service would not have to include $3 billion as a mandated incremental operating expense in fiscal year 2006. We also support relieving the Postal Service of the burden of funding retirement benefits attributed to military service and returning that responsibility to the Department of the Treasury. We support the use of savings to pre-fund retiree health benefits obligations for current and former employees, estimated at approximately $50 billion. Under the proposal, the funds would stay in the Civil Service Retirement System and therefore not impact the Federal deficit. Finally, we have recently been apprised of the difference in methodology used by the Office of Personnel Management and the Postal Service in determining the Postal Service's CSRS obligation. We were very surprised to learn that according to the Postal Service calculation, its obligation is $86 billion less. Somebody has to take a look at that.

Thank you for the opportunity to present these views. We look forward to continuing to work with you, Mr. Chairman, and the committee, to secure a sensible postal reform. And I remain available to answer any questions.

[The prepared statement of Mr. Palladino follows:]

TESTIMONY OF
VINCENT PALLADINO, PRESIDENT
NATIONAL ASSOCIATION OF POSTAL SUPERVISORS

SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT
COMMITTEE ON GOVERNMENT REFORM
U.S. HOUSE OF REPRESENTATIVES

FEBRUARY 5, 2004

Thank you, Chairman McHugh, for the opportunity to appear before the Special Panel on Postal Reform and Oversight on behalf of the 36,000 postal supervisors, managers and postmasters who belong to the National Association of Postal Supervisors.

I am pleased to be here today to participate in this hearing to add our voice in support of Congressional passage of comprehensive postal reform. This hearing is an important step toward the achievable goal of passing a postal reform bill this year.

It is increasingly clear that we need to modernize the business model and the laws governing our nation's postal system. Electronic diversion and the steady decline in First-Class mail volume threaten the capacity of the Postal Service to support itself through postal revenues. The sooner postal reform comes about, the greater will be the Postal Service's ability to focus on its core business of delivering the mail with more flexibility and higher profits.

The President's Commission on the United States Postal Service rendered a valuable service in submitting a report that affirmed the need to transform the Postal Service to a more high-performing, results-oriented, transparent and accountable organization.

Some of the Commission's recommendations can only be implemented by Congress through statutory action. Others can be implemented by the Postal Service itself, without the enactment of new legislation.

The Postal Service, within its own current authority, can move ahead in implementing the Commission's recommendations that address: the improvement of its financial transparency; the downsizing of its workforce, post offices and plants; the elimination of redundant management structures; the improvement of labor-management relations; the broader development of private-sector partnerships; the expansion of retail services; and the procurement of new technologies that improve the processing, transportation and security of the mail. Many of the Commission's recommendations in these areas represent constructive contributions, and we encourage Congress to assure that the Postal Service follows-through on these recommendations.

The Postal Service cannot get the job done alone, however. Bold action by Congress is required to modernize the nation's postal laws, which have remained unchanged for more than 30 years.

My testimony today is devoted to four areas that should be embraced by postal reform: rationalizing the postal network; achieving effective labor-management relations; improving pay and performance incentives; and postal pension funding reform.

Rationalizing the Postal Network

We agree with the Postal Commission that the current network of post offices and plants requires streamlining – leading to the closure of unneeded facilities -- to assure that universal service is delivered in the most effective and cost-efficient manner possible. Indeed, many of the nation's post offices are probably no longer necessary to fulfill the universal service obligation.

Streamlining or rationalization of the postal network should be carried out on a comprehensive basis under the authority and control of the Postal Service, in consultation

with Congress and its stakeholders. The ultimate aim should be to arrive at cost savings, while preserving affordable universal service.

We see no need for the establishment of a Postal Network Optimization Commission (P-NOC), as recommended by the President's Commission, applying a base-closing approach toward unneeded postal facilities. A base-closing approach, with P-NOC preparation of recommendations to Congress to consolidate and rationalize the Service's processing and distribution infrastructure, will only delay and diffuse the decision-making that should remain in the hands of the Postal Service. The Postal Service is the best-equipped entity to arrive at the optimal number, locations and functions for mail processing and distribution functions, just as the Postal Service is similarly equipped to arrive at the optimal number, locations and functions for post offices.

Under current law, the Postal Service is not allowed to close post offices for economic reasons alone. The Commission recommended that such statutory restrictions be repealed and that the Service be allowed to close post offices that are no longer necessary for the fulfillment of universal service. We agree and urge the Congress to grant to the Postal Service the flexibility – and necessary accountability in fair and rational ways – to fulfill its universal service obligation in a cost-efficient and effective manner.

Achieving Effective Labor-Management Relations

Adversarial labor-management relations have been a persistent cause of problems in the operational efficiency, as well as the culture and work life, of the Postal Service. The General Accounting Office and others have repeatedly documented the degree to which poor communication, persistent confrontation and conflict, excessive numbers of grievances, and difficult labor contract negotiations have persisted within the Postal Service.

From my perspective, as president of one of the foremost management associations within the postal service, progress is being achieved in fostering better communication at the national level between the Postal Service and leadership of the craft unions and the management associations. However, progress in lower levels and in other areas continues to remain uneven, especially in the resolution of grievances.

The Postal Commission noted that "encouraging progress" is being made by the Postal Service and one of its unions in resolving grievances through use of a streamlined grievance process involving a "dispute resolution team" (DRT), comprised of representatives of management and the craft. We believe the DRT approach is best directed to the resolution of contract-related disputes in the field where they began, while workplace environment disputes are best resolved by mediation. We also are concerned by the growing reliance by DRT upon non-binding arbitration decisions as precedent by dispute resolution teams. We encourage the Panel to continue its oversight to these endeavors.

Improving Pay and Performance Incentives

Over the past decade, the Postal Service has led the federal government in efforts to build incentive-based, performance-driven compensation systems. It has followed the lead of cutting-edge organizations in the private sector in using performance management systems to accelerate change and improve individual and organizational performance.

Incentive-based pay systems within the Postal Service currently apply only to the performance of executives, managers, postmasters, supervisors and other nonbargaining employees, i.e., management employees covered under the Executive-Administrative Schedule (EAS). More recently, the National Association of Postal Supervisors and the postmaster organizations have collaborated with the Postal Service in establishing a new pay-for-performance system, reshaping the EVA system first established in 1995, that better rewards teamwork, efficiency and service quality in a fair manner. Measurable and realistic goals are now being established at the unit, district and area levels as part of the new system. Progress is being made.

We agree with the Commission that it is time to expand merit-based pay to the entirety of the postal workforce, including bargaining-unit employees. The establishment of an incentive-based culture of excellence in any organization relies upon performance management systems that reach across the entire organization and cover all employees, not only those in the management ranks.

The Commission urged the Postal Service to undertake a study of performance-based compensation programs for both management and union employees and work with the unions and management associations to design and implement a performance-based compensation program. We are counting on the Postmaster General and the craft unions to negotiate some form of pay-for-performance at the bargaining table.

We also urge Congress to repeal the current statutory salary cap as it applies to the Postal Service (currently $171,900) and that the Postal Service should be authorized to establish rates of pay for top Postal Service officers and employees that are competitive with the private sector. Pay compression of salaries at the top, leaving little financial incentive for top and mid-level employees to take on new levels of responsibility, are hindering the Postal Service from recruiting the "best and the brightest" to top leadership positions. The cap should be lifted and the Postal Service should have the discretion to set compensation to attract and retain qualified individuals in the upper management ranks. Many Federal entities that require a capable, experienced CEO and other top officers already have pay-setting authority. These include the Tennessee Valley Authority, the Federal Reserve Board, the Public Company Accounting Board and the Federal Home Loan Bank Board.

Additionally, we encourage the Special Panel to take a critical view toward the necessity of establishing a new regulatory body, such as a Postal Regulatory Board, to assume authority over total compensation, scope of the monopoly, and definition of universal service, as well as other important policy and regulatory powers exercised by Congress, the Postal Rate Commission, and the Postal Service itself. Similarly, we question the wisdom of subjecting Postal Service pension and post-retirement health benefits to collective bargaining. This could significantly impact the vitality of the entire federal pension and retiree health benefit programs, and we caution the Congress to move very carefully, in full consultation with the postal stakeholder community, before proceeding in these areas.

Reforming Postal Pension Funding

We support the Postal Service's proposal to eliminate the escrow requirement so that the Service would not have to include $3 billion as a mandated incremental operating expense in FY 2006. The Service cannot use the escrow funds unless Congress eliminates the escrow requirement or specifies by law how these funds may be used. If no action is taken, the unavoidable necessity to raise rates higher than necessary will come about. This can and should be avoided. We believe that improved and continued communication by the Postal Service with Congress over how it will address its long-term challenges and fund its retiree obligations should provide Congress the information it needs and the assurance to eliminate the escrow requirement.

We also support relieving the Postal Service of the burden of funding retirement benefits attributable to military Service, and returning that responsibility to the Department of the Treasury. We support the use of those savings to pre-fund retiree health benefits obligations for current and former employees, estimated at approximately $50 billion. Under this proposal, the funds would stay in the Civil Service Retirement System (CSRS) and therefore would not impact the federal deficit.

Finally, we have recently been apprised of the difference in methodology used by the Office of Personnel Management (OPM) and the Postal Service in determining the Postal Service's CSRS obligation. We were very surprised to learn that according to the Postal Service's calculation, its obligation is 86 billion dollars less.

Thank you for the opportunity to present these views. We look forward to continuing to work with you, Mr. Chairman, to secure sensible postal reform. I am available to answer any questions you may have.

Mr. MCHUGH. Thank you very much, Vincent, and again I deeply appreciate your years of commitment to this, I congratulate you.

As I had a chance to go through your written testimony, all three—with the exception of the approach on some of the closure issues—you obviously all three are pretty much on the same page. One of the issues that the Commission identified in what they called "critical" to controlling the future costs of and capabilities of the Postal Service is the ability of management and labor to work together to constructively determine the right size of the Postal Service work force, as they put it, to ensure flexibilities in its deployment. As management associations, your folks are out on the floor and are the main line of interface between management and the workers. What do you feel, if anything, is something that this panel should work to get into whatever reform bill we might do legislatively to enhance that opportunity for cooperation and a better work force management relationship? Is there anything legislatively or is that just something that has to be worked out almost on a personal level? Wally.

Mr. OLIHOVIK. Mr. Chairman, I do not know about legislatively. It could possibly be done internally among ourselves. I think one of the biggest things that we all seem to agree on is the pay for performance program that we put implemented. I have been in the Postal Service now for over 25 years. I think we have made some tremendous strides with the unions. If you take a look at the individuals that you had up here before us, I think each and every one of them had a 21st century mentality of where this organization, the Postal Service, needs to go.

We all have to clearly be on the right path and it should be the same path. I mean, I am very, very optimistic about the new pay for performance program that we have recently talked with the Postal Service Headquarters about. We had a lot of input into that program. But, as I said in my prepared remarks, it is very, very, difficult when you have one group going in one direction, being rewarded for a certain set of principles, and another group going in another.

I think the idea of striving for excellence together will really bring us right at the end. And I know it is not going to be as easy as I possibly think it might be at this point in time. But, we have good recognition. I mean, being a postmaster, I have held a lot of positions in the Postal Service. I will tell you, being a postmaster, looking at some of my fellow postmasters, they are some of the most dedicated people. We are the people that are out there on the front lines every day dealing with customers, and we fully realize, Mr. Chairman, that those customers are not our enemies. Those customers are our valued customers, and we need them. I would rue the day that they ever thought of taking their business and going elsewhere. So, it is going to take a collective effort to head in the right direction. I think that the pay for performance model that we are under now is a good first step.

Mr. MCHUGH. Thank you, sir. Steve.

Mr. LENOIR. I would also like to point out that relations between the unions and management associations and postal headquarters, I believe, is at an all-time high. I think we are working together

on the same page, and I think we want to continue in that direction.

I would also like to point out that the number of grievances has decreased dramatically. That was a major problem 2 to 3 years ago that the Postal Service decided to tackle head on, and I believe we have made a lot of progress in that area.

One area that I do think we could work toward is flexibility in how we can use our employees. Currently, in a large post office, if a clerk has down time and tries to push a mail cart across the floor, that is mail handler work. We may need a little flexibility in how we can use our employees. And I am not certain if that is a legislative remedy or if that is just something we need to sit down and work with our unions on, to revise outdated rules.

Mr. MCHUGH. Thank you. Vince.

Mr. PALLADINO. To be blunt, I do not think we need any legislation. I think with the new Postmaster General in cooperation, we have been working together, things will change, but I think it has gone pretty fast. You were there when we had to go through the Federal Mediation to have a meeting. We do not do that anymore, the Postmaster General calls it, everybody shows up, we all have our say and I think we can do better in the future; in fact I know we can.

The workroom floor rules can be talked about with the craft. I think they are responsive today and we are working together. So I would rather it be left with the Postmaster General and the stakeholders to make this Postal Service better and better.

Mr. MCHUGH. Thank you, sir, I appreciate it. Mr. Davis.

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

Gentlemen, as we go through this process of determining what the postal system is going to look like, I think there is going to be a great deal of conversation trying to determine what universal service will actually mean. And I think we are going to look at the whole notion of what extent do we consolidate or will we see the consolidation, especially of smaller postal units, throughout the country. Could you help me with how you think we can reconcile those two notions. One, universal service, what are we really talking about, and whether or not consolidation of any units will help shape the ability to provide universal service in terms of resources being available to do that, so could you——

Mr. OLIHOVIK. Congressman Davis, I would like to say my definition of universal service is delivering every day to everybody, and one of the things that is very important that we have to keep in mind is uniform pricing. I think on one of the last panels we might have gone a little bit on a tangent with the cost of pricing, taking it from one location to another. I for one, would hate to see the day where we are charging all sorts of different prices throughout this country based on where you live. I think that would be the absolute wrong way to do it. We can never look upon rural America as being second class citizens.

As far as looking at what the network might look like, I am absolutely certain that, in order to be successful, we are all going to have to be involved in shared sacrifices, there is no doubt about that. There are some people who believe that you cannot close post offices. There is nothing written anywhere that says you cannot

close a post office. There is no moratorium as of today on closing post offices. We have a very defined process and the historical record will speak for itself. When that process has been followed, we have in fact closed 14,000 post offices within the last 30 years. There are other options and in many of our big cities we have things called contract postal units to assist.

The process was put in place for a very, very good reason, because before you take that drastic step of telling a community that you are going to close their post office, you better take everything into consideration. It would be very different if you were to define why we should be closing post offices. I would suggest to you if you use the yardstick of a post office losing money that would be an improper yardstick for closing a post office. I would suggest, if you look at the record, that in the State of Maine, where Chairman Susan Collins is from, that if you were to use that yardstick for closing a post office, you would in fact close 77 percent of the post offices in the State of Maine. And where committee member John Sununu is from, my home State, New Hampshire, you take a look at that you would be closing a similar amount.

I do not think that is the way to go. I think that the process is an established process and I think if people follow the process, the Postal Service has done it—and as I said, 14,000 post offices have in fact been closed by following that process over the last 30 years.

Mr. LENOIR. Congressman Davis, I appreciate your effort to try to get a clear definition of universal service. We share that same concern.

My friend Dale Holton from the Rural Carriers said that the rural carriers were a post office on wheels and provided every service that the post office did. I respectfully disagree with that assessment. Just like in the weather here, would you like for your grandmother to have to figure out when the rural carrier is coming by her house and sit out in front of the mail box and wait for services? I just do not think it is an equal service if you take that option away from rural America.

There are so many things that we do in those offices that it is hard to put a dollar value on. We have people in my hometown that did not have an educational opportunity and we help fill out money orders, answer mail and do things for those people that otherwise would not be done, and it is very hard to put a dollar amount on those things.

As far as the network of plants and things of that nature, we are a customer of the plants, we ultimately receive the mail at our post office put together by those plants. And how they are aligned, we are not taking a strong stance on that now, we just want to do what is best for the Postal Service. But I think the key is to utilize the full value of the network that we have out there. I do not think we fully maximize the value of our post offices. And I think there are other services that we could be providing that would bring us closer to the break even point.

Mr. PALLADINO. I have a wider prospect on what you—on the question you are asking. We are in a position where we are losing mail and losing revenue and doing what every company in the United States today is doing, we are reducing support jobs, and we

will reduce plants. If we can get the mail to the post office with one less plant the post office is going to do it.

And the reason that we are looking for some help is because, I think, if we get this help from you all, we can do it through attrition, not through something that has to be done drastically like we did in 1992. But eventually we are going to cut somewhere or we are going to have to go for subsidy.

So I think it is like a "catch 22;" we want to get to the most efficient source with the right price and in order to do that we are looking for postal reform, for flexibility to get there. And I do not know if that answered your—I think you were talking about downsizing. I think it is a fait accompli. We are going to right-size or whatever term you want to use, they are looking at all of our support positions to bring it down to where they can serve and still serve everybody correctly. And the same thing is being done with mail processing and possibly post offices.

Mr. DAVIS. Well, I do not know if we get there, but it is certainly helping as we try to rationalize the most effective approach to looking at the needs of all the different types of communities that exist in our country and look at the needs of those individuals who have given so much of themselves to try and make systems work. And your testimony has certainly helped me as I try to determine where I am, where I stand and what approach I think really works.

So I certainly want to thank you for coming in and sharing and giving that information. That helps a committee or helps an individual like myself make a determination when ultimately we reach the point where there is no return and you just have to simply decide where you are.

So I thank you very much. Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman as always. Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman, and thank the three of you. I want to identify myself with what Mr. Davis said. I have learned a lot, too. It was worth coming to this cold city to hear all this today and I really appreciate it.

I was going to ask Mr. LeNoir questions about transferring excess post offices in local communities. I will not because you have all pretty much discussed that. I think I heard you say that the savings would "only be" $500 million. I am not a rich guy and I would love nothing better than to take $500 million home to the Second District of Virginia for the military, for education, for highways, and a lot of things. I would be the hero forever. So, I think that is a lot of money. As the man whose name is on this building said, "A million here, a million there and pretty soon you are talking about real money." To me $500 million is a pretty substantial sum of money that I would take any day of the week to take home to the district I represent.

I just have one final question. Do you support allowing the postal system to retain their earnings and how do you think those earnings should be used? To what use should they be put? All of you.

Mr. OLIHOVIK. I do support that concept. I think there are a number of things we can do and I think one of the main things that we need to look at is our capital expenses right now. We have had too many buildings that have been put on hold as far as needed

repairs in the facilities and I think that is one of the things that we could look at. I do support that concept.

Mr. LENOIR. Congressman, I also support that concept because with the rate cycle we have now, the first year you are supposed to make money, and the second year break even, and then lose money the third year. It just seems like a vicious cycle.

I would like to comment on your $500 million comment. I certainly am not trying to trivialize that amount of money, not whatsoever, but if you look at it compared to a $70 billion budget, you have to put it into perspective. As we said, we are trying to figure out ways we can make additional funds that we are not currently making. I will use an example. In my little office I put in a fax and copy machine because the closest service was 20 miles away. I cannot compete with private industry, yet it allowed us to make additional revenue in that office and it paid for itself many times over.

Mr. SCHROCK. Sure, I agree.

Mr. LENOIR. So I just think we need to look at solutions like that so we can close that $500 million gap.

Thank you.

Mr. SCHROCK. Thank you. Mr. Palladino.

Mr. PALLADINO. Repair our infrastructure and reduce our debt.

Mr. SCHROCK. What is it, $87 billion in infrastructure and $90 billion in debt? We need to help.

Mr. PALLADINO. Yes.

Mr. SCHROCK. Again, thank you. Thank you for allowing me to come here and thank you all for being here as well.

Mr. MCHUGH. I thank the gentleman for coming here. I have been in Congress for 12 years and I still happen to believe that, as my colleague from Virginia suggested, $500 million is worth thinking about. I know for many that is a rounding error. [Laughter.]

But I think the point that Mr. Olihovik made is still relevant, that if you were to close every post office under that rubric, the savings would be, in a relative term to the entire financial situation of the Postal Service, kind of minor. But the political ramifications would be enormous. I may have mentioned Pierrepont Manor—[laughter]—you close that post office in Pierrepont Manor, in my humble opinion—the mail service component is obviously paramount, but that is the one public facility we have in that entire community 214—213, I am out of town. And it is a meeting place, it is a facility that gives a sense of community. Now, I am not saying that we should save every post office in America, but I am saying it is important and it has to be considered, is the only point I would make and I would fully endorse what President Olihovik said, in spite of the current impression to the contrary, and the Commission made a distinction, it really did. It talked about lifting the financial consideration component of the barrier against closures. But we can—the Postal Service can close post offices today. And I am not encouraging them necessarily to do that, but they are empowered, they just have to go through a process. I think a community that has such a stake in a facility should have available to it a process by which to take its case and be heard. Again, I am editorializing.

Before I close the hearing, and with my appreciation to the final panel, I want to emphasize something that I hope I made clear in my opening comments. We are here today resurrected from the grave of congressional irrelevancy, in large measure because of President Bush and the work of his Commission, and I thank him for that. I hope I made that clear. And if there is any question about the interest and dedication of the administration to this initiative, I think it is important that I underscore that we are joined very quietly, and I do not believe he has made his presence known to anyone but he has been spotted, by Mr. Roger Kodat, who is the Deputy Assistant Secretary, I believe, for Government Financial Policy—did I get that right, Roger—who just flew out here for this hearing, and came out and sat and listened, and to have a Deputy Assistant Secretary of a Federal department here to monitor the progress and what has been said, I think underscores what I, as I said, tried to convey.

This is an important issue to this administration, and for no other reason alone I commend the President and his administration, particularly the Department of Treasury which has been so interested in this, for their interest.

Gentlemen, thank you so much for being here. As I tried to indicate, I appreciate the work you do, appreciate the management associations' members and the great work that they do. When I go in and see my postmaster, you know, she is one of yours. And we look forward to working with you collectively on a bipartisan basis to try to do something that ensures the future one of the most important organizations in this Nation, the U.S. Postal Service. God bless you.

And with that we adjourn and look forward to the next trip to Chicago. I hope it is sooner than 7½ years, as the last one was for me.

Mr. SCHROCK. As long it is in the summer.

Mr. MCHUGH. Yes, well, we will talk to Congressman Tom Davis about that. But, Danny, thank you so much for your hospitality and thank you for letting us be in your wonderful city and district.

Mr. DAVIS. Thank you for being here.

Mr. MCHUGH. The hearing is adjourned.

[Whereupon, at 3:28 p.m., the special panel was adjourned.]

[Additional information submitted for the hearing record follows:]

Testimony for the Record

Statement of
Thomas Tulipan, National President
Fraternal Order of Police
National Labor Council, No. 2

Before the
House Special Panel on
Postal Reform and Oversight

Chicago, IL
March 5, 2004

I would first like to thank Representative McHugh for convening this important forum, and for inviting me to offer testimony regarding labor's view of postal reform. I would also like to thank the other distinguished Members of the House Special Panel for their commitment to this important legislation.

The Fraternal Order of Police, National Labor Council 2, is the exclusive collective bargaining representative of nearly 900 postal police officers employed by the United States Postal Service (USPS). I represent these officers, who are assigned to 22 postal facilities throughout the United States and Puerto Rico. Postal police officers are committed to the safety and security of the Postal Service, and are equally committed to the reforms necessary for the sustainability of the postal system.

The Fraternal Order of Police, National Labor Council 2 (FOP) has always been supportive of Congressman McHugh's postal reform initiatives and other postal legislation, specifically the legislation which resulted in the creation of an independent inspector general's office in September 1996.

The FOP firmly supports the views of the Postal Service Inspector General's office in regard to the commission report and postal reform. We feel that the IG's views on the various commission findings are representative of what is best for long term survival of the postal system.

Regarding reform, the FOP believes that accountability is of utmost importance. Without accountability, problems may be masked by spending more money. The following example highlights but one of the many reasons we believe this reform is necessary:

In 1995, postal police officers began training at the Federal Law Enforcement Training Center (FLETC) in Glynco, Georgia. This Department of the Treasury facility trains police officers and agents from most governmental law enforcement agencies. By the Postal Inspection Service's own admission, postal police officer training was comprehensive and produced well-trained and well-motivated officers. In addition, based on partnering agreements, the costs associated with the ten-week training program were minimal.

In August of 2003, however, a decision was made to cancel postal police officer training at the FLETC, and to replace it with a six-week "in-house" training program to be conducted at a postal training facility in Maryland. By the Postal Inspection Service's own admission, the shorter training program would be more costly than FLETC training.

For obvious reasons—and in our opinion--less comprehensive and more expensive training was not in the best interests of postal police officers, postal employees, or postal customers. We recognize that an increase of thousands of dollars associated with postal police officer basic training costs is minimal in relation to other postal practices. However, we firmly believe that the Postal Service's best chance for survival rests in controlling costs and the cited example shows a complete disregard for fiscal responsibility. This is but one small example of the necessity for reform legislation to be enacted during the current legislative session.

Another example involves an incident which resulted in an official inquiry from Congressman J.D. Hayworth. In 2001, Congressman Hayworth asked the nation's top postal officials for an immediate briefing on the June 2, 2001 theft of an estimated $2.7 million from the Phoenix General Mail Facility. Hayworth further requested a congressional inquiry into the handling of the case by postal inspectors. Hayworth said he wanted to know details of the theft, how security was breached and "what is being done to correct the flawed system." He also called for "immediate action to end the disastrous communications blackout that has undermined public confidence" in the postal system. Postal officials concealed the heist until they got an arrest warrant for Louis M. Holley, an employee who vanished with the money.

A few months after the $2.7 million theft from the unprotected postal facility, the thief was apprehended. While off-duty, Postal Police Officer Gary Fournier tracked the criminal to a hotel room in Lynwood, Washington. Fournier, a 55-year-old ex-Marine, had been with the Postal Service for 18-years, the last six as a postal police officer in Seattle.

The man Fournier captured had disappeared and eluded Postal Inspectors and local police for over two months. Based on Fournier's initiative, more than $1.8 million in cash was recovered at the scene, and another $800,000 in checks and money orders were recovered later. The subject was convicted and is now serving 41 months in prison.

Fournier's story should have a happy ending there. Unfortunately, Officer Fournier was forced into early retirement when the Seattle Postal Police force was deemed unnecessary and was eliminated in 2003. Fortunately, the closing did not come sooner, or the Phoenix theft may never have resulted in an arrest and conviction. Had officer Fournier's job been eliminated sooner, Postal Service coffers might still be missing $2.7 million.

The cited examples detail our belief that any reform legislation should take into account the safety and security of the postal system, which includes customers, employees and assets. This Forum should not be comforted by the fact that the Postal Service has eliminated postal police operations in six cities—eliminations which have drawn Congressional and Inspector General inquiry.

Additionally, labor-management problems cost the Postal Service millions of dollars each year. Much of this cost is related to the thousands of grievances filed annually and the missed opportunities to prevent and/or resolve grievances at the lowest possible level. Although the Inspector General has made numerous recommendations on how to improve relations between the Postal Service and its unions, many of these recommendations have not been fully implemented.

Regarding the labor management aspect of the commission report, over the past three years, our union has worked with management in an effort to reduce the number of outstanding grievances. Resolving labor management problems is necessary in order for the Postal Service to survive. In order to operate effectively, the Postal Service needs to give employee issues a higher priority and enhance each employee's contribution to organizational performance. This is simply not the case at present.

Our union has often gone on record as stating that we want to do more work. We have requested to be more involved in necessary law enforcement work—including such work as protecting carriers who are too often assaulted and robbed while on their routes and protecting postal remittances. While such work can easily be incorporated into our statutory functions, all such overtures have been ignored by the Service, even as the detailed crimes escalate.

The commission report details crime prevention and security; mail theft; robberies and burglaries; assaults and threats; stating:

> ***The Commission recognizes that the Postal Inspection Service plays a vital law enforcement function. Only those activities of the Postal Inspection Service that directly support the safety and security of the nation's mail and postal systems should be assumed by the ratepayers. The cost of law enforcement operations that track broader crimes committed through the mail should be borne by taxpayers, generally.***

The FOP agrees with these findings. Postal police officers support the safety and security of the mail, and as such, their functions should be assumed by the ratepayers. Postal police serve a vital function, especially following the events of 9/11 and the October, 2001 anthrax attacks.

Safety and security of the postal system are of utmost importance. Trust, convenience, safety, security and customer satisfaction are more important than the absolute lowest cost. Policy makers urgently need to understand the vulnerabilities of the Postal Service, and these vulnerabilities should be considered in any forthcoming reform legislation.

Thank you again for asking our views.

ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM—PART III

WEDNESDAY, FEBRUARY 11, 2004

HOUSE OF REPRESENTATIVES,
SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT,
COMMITTEE ON GOVERNMENT REFORM,
Washington, DC.

The special panel met, pursuant to notice, at 1:02 p.m., in room 2154, Rayburn House Office Building, Hon. John McHugh (chairman of the special panel) presiding.

Present: Representatives McHugh, Burton, Schrock, Miller, Murphy, Blackburn, Davis of Illinois, Towns, Maloney, and Clay.

Also present: Representatives Tom Davis of Virginia, Shays, and Waxman.

Staff present: Robert Taub and Jack Callender, counsels; Drew Crockett, deputy director of communications; Teresa Austin, chief clerk; Allyson Blandford, office manager; Michael Layman, professional staff member; Phil Barnett, minority staff director/chief counsel; Kristin Amerling, minority deputy chief counsel; Althea Gregory, minority counsel; Denise Wilson, minority professional staff member; Earley Green, minority chief clerk; and Cecelia Morton, minority office manager.

Mr. MCHUGH. The panel will come to order. With the gracious agreement of Mr. Davis' staff, the ranking member who is on his way—he will be here shortly—he has agreed to let us try to begin this hearing. I certainly want to welcome all of you here today.

This is the third installment of three panel sessions that we have had during the past 2 weeks. In that task, we continue today to examine the President's call for postal reform, which he made in December and reiterated again in his budget message that was presented to Congress on February 2. Today, we are truly honored and want to welcome highly esteemed panels, two of them in number, of chief executive officers representing the views of customers, competitors and postal-reliant businesses.

I have said it before and I will say it again, and certainly our witnesses, I believe you will hear today, know it all too well. The Postal Service is the focus of a nearly $900 billion-a-year in industry activity. It employs some 9 million workers nationwide, and it represents approximately 8 percent of our Nation's gross domestic product.

Our Postal Service is in trouble and it requires reform to preserve universal service and prevent a worsening crisis. Last week, in a panel held in the ranking member's hometown of Chicago, we heard unanimous support from the Postal Service employee groups

for the administration's broad principles on postal reform. Two weeks ago, in our first session, the Postal Service itself, along with the administration, the Rate Commission, and the General Accounting Office, all testified that universal postal service is at risk and that reform is urgently needed to minimize the danger of significant taxpayer bailout or dramatic postal rate increases. All agreed that the Postal Service's current business model, formulated as it was in 1970, is no longer sustainable going into the 21st century. To understand the challenges at hand, one needs simply to read the testimony we received regarding the enormous liability still facing the Postal Service, the serious declines in mail volume and revenue, changes in the mail mix, increased competition from private delivery companies, declining capital investment, insufficient increases in postal productivity, uncertain funding for emergency preparedness, and major impediments to continued cost cutting.

While the problems are clearly dire, I believe the President's principles for legislative change identify a path to some solutions. Fortunately, there currently exists the strong bipartisan basis upon which to proceed, including the highly refined bill that we developed in the last Congress with Representatives Davis, Waxman and Burton. Senator Carper has introduced an almost identical version of our legislation in the Senate.

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

I would like to thank all of our witnesses for appearing before the committee today, and I look forward to their testimony. I will have the honor of introducing them in a moment, but before I do that, as I said, we would like to cover opening statements. As I begin to yield, I see the ranking member of the full committee, Mr. Waxman, the gentleman from California, has joined us. Do you want to make your opening statement now?

Mr. WAXMAN. Sure.

Mr. MCHUGH. I would be delighted to yield to him. He was out of the room, so I will repeat it. I deeply thank the gentleman for his leadership, for his input, and for being here not just today, but through this entire challenge.

Mr. Waxman.

Mr. WAXMAN. Thank you very much, Mr. Chairman. I am pleased to join with you in this third hearing on postal reform.

The Postal Service is one of the country's most venerable institutions. Since its inception over 200 years ago, the Postal Service has played a vital role in our national commerce. Today it remains integral to business activities around the country and the world. The postal system supports an $891 billion industry, representing over 8 percent of the gross national product. Businesses and families across America depend each day on Postal Service delivery and services. Rain or shine, the Postal Service now delivers more than

200 billion pieces of mail a year to roughly 141 million addresses. The Postal Service is an American institution that we must protect.

Yet this historic institution that is so vital to our Nation is facing enormous challenges. The Internet and e-commerce are eroding mail volumes. Security threats like anthrax and ricin pose new risks. The Service is operating under a set of laws that have not been adapted to the changing delivery environment. While the postal pension law we enacted last year provided some immediate financial relief to the Postal Service, the Postal Service continues to face large financial challenges. The Postal Service's unfunded health care liabilities alone are estimated at between $47 billion and $57 billion.

Our challenge is to modernize the laws that govern the Postal Service so that it can remain effective and viable in the 21st century. This will not be easy, because the Postal Service affects so many parts of our economy. A wide range of organizations with many conflicting interests will be affected by what we do, but change is essential if we are to strengthen and preserve the Postal Service.

A key part of this process is that we listen well and that is why today is so important. Today's witnesses range from printers to delivery companies, from a catalog merchandiser to a nonprofit organization, from a greeting card company to a direct mail marketer. All of these businesses are dependent on the Postal Service. The Postal Service's success will contribute to their success, and a withering Postal Service will impact these businesses, their customers and their employees.

Similarly, these businesses, each in their own way, contribute to the Postal Service's success. For example, many of the companies we will hear from today play an important role in providing the mail volume that is so important to the Postal Service's viability. I look forward to hearing their views on the importance of rate stability, price flexibility, continuation of universal service, and enhanced regulatory authority.

As I conclude my remarks, I want to commend three of my colleagues who have taken crucial leadership roles in this process: Chairman Tom Davis, Postal Panel Chairman John McHugh, and Postal Panel Ranking Member Danny Davis. Chairman Davis said last fall that if this committee is going to pass postal reform legislation, the legislation has to be a bipartisan product, and that is exactly the approach that we have been following.

Thank you all for your interest and I look forward to hearing the testimony.

[The prepared statement of Hon. Henry A. Waxman follows:]

Statement of Rep. Henry A. Waxman, Ranking Minority Member
Committee on Government Reform
Special Panel on Postal Reform and Oversight
Hearing: "Answering the Administration's Call for Postal Reform – Part III"

February 11, 2004

I am pleased to join my colleagues in this third hearing on postal reform.

The Postal Service is one of the country's most venerable institutions. Since its inception over 200 years ago, the Postal Service has played a vital role in national commerce. Today, it remains integral to business activities around the country and the world.

The postal system supports an $891 billion industry representing over 8% of the Gross National Product. Businesses and families across America depend each day on Postal Service delivery and services. Rain or shine, the Postal Service now delivers more than 200 billion pieces of mail a year to roughly 141 million addresses. The Postal Service is an American institution that we must protect.

Yet this historic institution that is so vital to our nation is facing enormous challenges. The internet and e-commerce are eroding mail volumes. Security threats – like anthrax and ricin – pose new risks. The Service is operating under a set of laws that have not been adapted to the changing delivery environment. And while the postal pension law we enacted last year provided some immediate financial relief to the Postal Service, the Postal Service continues to face large financial challenges. The Postal Service's unfunded health care liabilities alone are estimated at between $47 and $57 billion.

Our challenge is to modernize the laws that govern the Postal Service so that it can remain effective and viable in the 21st century. This will not be easy. Because the Postal Service affects so many parts of our economy, a wide range of organizations with many conflicting interests will be affected by what we do. But change is essential if we are to strengthen and preserve the Postal Service.

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Thank you for your interest. I look forward to hearing today's testimony.

Mr. MCHUGH. I thank the gentleman, and again express my appreciation for rolling up his shirtsleeves as always, and becoming so productively involved in this issue.

Next, I would be honored to yield to the gentleman from Virginia, the chairman of the full committee, who truly has taken the leadership role in this process, who has not allowed it to sit on the back burner, but has dragged the pot from the back to the front of the stove, my friend Mr. Davis.

Mr. DAVIS OF VIRGINIA. Thank you very much. I want to begin, Mr. Chairman, by thanking the chairman of the special panel, John McHugh, for yielding. I would especially like to thank him for his leadership and vision on this important issue and for conducting this series of hearings.

The panel's first two hearings have been very instructive and have also made it clear that there is a broad consensus developing around the administration's five principles for postal reform. Perhaps the stars at long last are aligning. I look forward to working with Chairman McHugh, the ranking member of the committee, Mr. Waxman, the ranking member of this panel, Danny Davis, and other members of the special panel to craft postal reform legislation that will allow the Postal Service to survive well into this century.

We have two very distinguished panels of witnesses here today and I want to thank each of them for taking the time out of their busy schedules to appear before us. I should note that the special panel would have benefited greatly from two witnesses who were invited to testify today, Mike Eskew, the CEO of UPS, and John Fellows, the CEO of DHL Worldwide Express in the Americas. Unfortunately, they both had unavoidable commitments so they were not able to appear, but they have submitted testimony for the record and we will give them an opportunity to appear in person later. I want to thank them for doing so.

Mr. Chairman, the last time Congress passed comprehensive postal reform many of the technologies that we take for granted today, such as fax machines, e-mails, the Worldwide Web, were the stuff of science fiction. But the threat of electronic diversion to the Postal Service's ability to provide uniform service at uniform rates is very real today. First class mail volumes have been in decline for several years and the only way the Postal Service can legally respond to declining volumes and revenues right now is by raising rates even further. As rates go up, even more volume leaves the system, contributing to what David Walker, who testified at the panel's first hearing, and is the head of the GAO, has called a "death spiral."

If we do nothing, the Postal Service will be defunct before we know it. I think the time is right for Congress to prevent this from happening. For the first time since the Nixon administration the White House has called for comprehensive postal reform. Our colleagues in the other body are as committed as we are to preventing the Postal Service from melting down. We also have the guidance of the President's Commission on the Postal Service, which did an extraordinary job in a very short amount of time. Last but not least, we can build on the 9 years of hard work that Chairman McHugh has devoted to this issue, and I might add, Chairman Bur-

ton before me. I look forward to working with him and the rest of our colleagues on the other side of the aisle as we confront this vital issue.

Thank you.

[The prepared statement of Chairman Tom Davis follows:]

OPENING STATEMENT
CHAIRMAN TOM DAVIS
GOVERNMENT REFORM COMMITTEE
SPECIAL PANEL ON POSTAL REFORM & OVERSIGHT
"ANSWERING THE ADMINISTRATION'S CALL FOR POSTAL REFORM"

11 FEBRUARY 2004

I would like to begin by once again thanking the Chairman of the Special Panel, John McHugh, for conducting this series of hearings, and I would especially like to thank him for his leadership and vision on this important issue. The Panel's first two hearings have been very instructive, and have also made it clear that there is a broad consensus developing around the Administration's five principles for postal reform. Perhaps the stars, at long last, are aligning. I look forward to working with Chairman McHugh, the Ranking Minority Member of the Committee, Henry Waxman, and the Ranking Minority Member of this Panel, Danny Davis, to craft postal reform legislation that will allow the Postal Service to survive well into this century.

We have two very distinguished panels of witnesses here today, and I would like to thank each of them for taking the time out of their busy schedules to appear before us.

Mr. Chairman, the last time Congress passed comprehensive postal reform, many of the technologies we take for granted today – such as fax machines, email, and the World Wide Web – were the stuff of science fiction. But the threat of electronic diversion to the Postal Service's ability to provide uniform service at uniform rates is very real today. First Class Mail volumes have been in decline for several years, and the only way the Postal Service can legally respond to declining volumes and revenues right now is by raising rates even further. As rates go up, even more volume leaves the system, contributing to what David Walker, who testified at the Panel's first hearing, has called a "death spiral." If we do nothing, the Postal Service will be defunct before we know it.

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Mr. MCHUGH. I thank the distinguished chairman for his kind comments and for his leadership on this issue.

For those of you in the back who cannot see the next speaker, you can look right up there and see him. [Laughter.]

That is not an exercise in ego. It is an exercise of the fact that he was the esteemed chairman of this full committee for the 6 years in which every Member is allowed if they are lucky enough, fortunate enough, hard-working enough, and good enough to reach that pinnacle. I will tell you that during my time previously as a subcommittee chairman and later as a special panel committee chairman, Dan Burton took this issue up and worked it to his fullest. You could not ask more of a full committee chairman than Mr. Burton to render unto this issue. So I am thrilled he asked, volunteered, aggressively pursued a position on this panel. It is a thrill for me to see him seated here today. I am honored to yield to him once more.

Mr. Chairman.

Mr. BURTON. Thank you, Mr. Chairman. Would you send a copy of your remarks out to my district? I really would appreciate it. [Laughter.]

I should look that good.

Let me just make a couple of brief comments. I have a statement I would like to present for the record, Mr. Chairman. But one of the things that is very important, in addition to having the administration get on board in trying to get legislation passed which will help solve the problems of the Postal Service, is to get the interested parties involved in a positive way.

Now, I do not mean to throw any rocks at anybody and I am not going to go into specifics, but there are certain organizations that have a vested interest in the Postal Service not doing as well as they should because they pick up market share. I think it is real important that this subcommittee and the chairman and the administration work very closely with these individuals to make sure that they are on board, because if they are not on board, then their employees will be lobbying their Congressmen and Senators against passage of legislation, and we will be in the same mess we are in now, 2 years from now and 4 years from now, and the situation will just get worse and worse.

So it is extremely important that all interested parties be involved in a positive way in coming to a positive conclusion about this legislation. FedEx, Mr. Smith, has been with us for a long, long time in trying to solve this problem. I really appreciate that. I hope that your counterparts in your industry will likewise look at this in a very positive way so that we can get on with solving this problem.

Ultimately, and I hope the industries that I am talking about realize that if the Postal Service goes belly up or becomes defunct down the road, it may in the long run look like it is going to be a positive for them, but it will not be. It will be a negative. So it is in the best interests of the private sector of this country, as well as the post office, to get together and solve this problem.

With that, Mr. Chairman, I thank you very much for giving me this time.

Mr. McHUGH. I thank the gentleman. Without objection, his entire statement will be entered into the record.

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

Opening Statement
Chairman Dan Burton
Committee on Government Reform
Special Panel on Postal Reform and Oversight
Title: "Answering the Administration's Call for Postal Reform -- Pt. III"
Date: February 11, 2004

Mr. Chairman, as I mentioned during our last hearing here in Washington, as a veteran of the old committee on Post Office and Civil Service, I have been active on postal issues for many years, and I have been profoundly frustrated by the inability of all parties to come together to resolve the complex and thorny issues surrounding postal reform.

During my last few months as Chairman of the Full Committee on Government Reform we came very close to moving a substantial reform package to the House Floor for a vote. But regrettably, we came up just short of the goal line.

We all know the challenges confronting the Postal Service; more than $90 Billion in debts and unfunded obligations, and an unstable financial outlook with mail volume rapidly declining as ever more postal delivery addresses are being added to the system.

For example, just last year the Postal system grew by 1.9 million delivery points, while for the third-straight year actual mail volume declined. First-class mail volume, historically the lynchpin of the Service's revenue stream, declined by over 3 Billion pieces, as customers increasingly transitioned to electronic alternatives. With Americans becoming more familiar and comfortable doing complex and personal correspondence online, the erosion in First-Class mail is bound to accelerate.

Because the Postal Service remains mired in a regulatory and management model that is nearly three decades old and does not provide the Service with the flexibility it needs to succeed in a rapidly changing market, the only way that declining revenue and increasing service can be reconciled is through ever more frequent and ever larger price increases. Price increases which only serve to drive more individuals and businesses away from the Postal system, resulting in what the General Accounting Office has referred to as a "death spiral."

None of us here today wants to see the Postal Service die. The Postal Service is the center of an $871 Billion industry employing 9 million workers nationwide, and representing more than 8 percent of our Gross Domestic Product. The Postal Service itself is a $67 Billion business, the 11th largest U.S. enterprise by revenue, and the second biggest employer in the Nation employing approximately 843,000 with a recruiting backlog of another 400,000 applicants.

The solution to this problem is going to take compromise, and not everybody is going to be completely happy with the final product. However, to wait until we have a perfect reform proposal rather than moving forward on a good compromise reform proposal

would be irresponsible and a disservice to both postal employees and the American people.

We have been discussing and debating postal reform since the early-1990s, and while we talked and debated the crisis grew ever worse. If we continue to talk this issue into the ground, and simply end up doing nothing, the financial death spiral of the U.S. Postal Service will continue. If we do nothing today to resolve the crisis, a massive taxpayer bailout looms just over the horizon. The end result will be a National disaster: a disaster for Postal Service management, for postal employees, and for the American people.

Today's hearing and the two previous hearings held by this Special Panel on February 5th in Chicago, and January 28th here in Washington, have given us an opportunity to listen to the ideas of postal management, the postal unions, and the various stakeholders in the private sector who do large volume mailing that we will hear from today. We need their input, but more importantly we need all of the interested parties to back up their ideas with a serious commitment to finally making postal reform a reality. For example, businesses have a strong incentive to encourage the trend toward electronic mail: processing a digital payment over the Internet costs between one-third and one-half the price of sending a check through the mail. So, like a three legged stool, reform is doomed to fail if businesses decide the price of reform is too high, or if the unions decide that reform endangers their bargaining rights. The line between success and failure is very fine, but I am here today to roll up my sleeves and work with my good friends and colleagues until we get the job done.

In closing Mr. Chairman, I want to thank you once again for holding these hearings. They have been an extremely valuable starting point, and I hope that we can build on what we have heard, and all work together in a bipartisan way to finally enact serious and meaningful postal reform. To do nothing, as I've said, would be a disaster.

Mr. MCHUGH. The next gentleman who hosted us last week in the Windy City, the great city of Chicago, who as I mentioned in my opening remarks has been an ever-present and ever-forceful individual in terms of this initiative, Mr. Davis, the gentleman from Chicago, from Illinois, and the ranking member on this panel as he was the ranking member on the subcommittee.

Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman. Let me apologize for being a bit late, but I have three hearings going on all at the same time. I have been trying to figure out how to do a double version of the Watusi, to go forward and go backward and you move. [Laughter.]

Let me thank you for, first of all, coming to Chicago with the hearing last week. All of us in the Midwest were pleased and delighted that we had the opportunity for a discussion in the greatest city in the country, with all due respect to all others.

But I am pleased to join with you in convening this hearing, and welcoming our witnesses today. This is the third of a series of hearings being held by the Special Panel on Postal Reform and Oversight. It is my understanding that a final wrap-up here will be held with the Senate Governmental Affairs Committee next month.

Last week, we heard from the postal employee unions and management organizations. The message was clear and resounding: collective bargaining has worked and worked well. Today, we will hear from postal business-reliant companies. To that end, I would like to give a special welcome to Mr. William Davis, chairman, president and CEO of R.R. Donnelley. Of course, R.R. Donnelley is a Chicago-based printing and logistics company located in my district. Mr. Davis' corporate and civic leadership has been outstanding.

I would also like to recognize Capital One and Pitney Bowes. Pitney Bowes and R.R. Donnelley were both in attendance at an advisory group meeting I held in Chicago last week, prior to the field hearing. In reviewing the testimony, I was pleased to note that we seem to agree on many, many of the important issues. We need and must protect universal service. The Postal Service needs flexibility to set rates and provide rate stability, and the Postal Service must not bear the military service payment obligation.

As my colleagues and I continue to work together to craft responsible postal reform legislation, I would like to commend our panelists for taking the time to be engaged and provide input into the process. Your support of our efforts is critical if we are to be successful in passing postal reform legislation. I only ask that you stay the course with us and stay engaged.

Again, Mr. Chairman, I want to thank you for your leadership, welcome our panelists, and look forward to all of our participation as we continue one of the great traditions of this country, and that is the ability to communicate from border to border at a cost that is possible for people to pay.

Mr. MCHUGH. Again, I thank the gentleman for his leadership.

Next, I would be pleased to yield to one of the newer Members of the House, one of the newer members certainly to this panel because it is a new panel—we are all newer members of the panel—but the gentlelady, again, like everyone else on the panel, sought

membership and who was very, very concerned about that. The gentlelady from Michigan, Ms. Miller.

Ms. MILLER. Thank you, Mr. Chairman. Certainly, your commitment to postal reform and creating a successful Postal Service is very much appreciated. I would also like to thank Chairman Tom Davis for his commitment to this issue, and certainly for allowing me the opportunity to serve on this panel as well.

I think with all the issues facing the Government Reform Committee, there are few that are more important than postal reform. I am pleased to be given the opportunity to help make a substantial change for the better. The Postal Service has not been subject to significant reform since its inception over 30 years ago. Its current business model is certainly not adequate for the 21st century, and we can do better. We need to do better.

Prior to coming to Washington, before I got this job, I was a township supervisor. I was a county treasurer. I was the Secretary of State in Michigan. All of these jobs were very administrative in nature, but each of them had a similar theme for me, and that was reform of an antiquated agency. So in each of my positions, my office conducted an expansive operational audit, initiated reform that resulted in more cost-effective practices, and certainly more efficient ways of doing business.

I think this same attitude seems to be certainly transferred to the Federal Government and so many of its agencies. Customer service needs to be a goal of each and every postal employee because when this kind of an attitude is combined with an effective business model, the customer is better served and business can actually expand.

The establishment of postal rates also have to be customer service oriented. If rates are unnecessarily high due to waste or inefficiencies, then such a situation would amount to really nothing less than a tax on citizens and businesses in our Nation as well. Certainly the witnesses before us today represent some of the Postal Service's biggest customers, and they need the predictability as they construct their own business models.

At the State level of government, we were always forced to make a business case for the reforms that we put forward. By law, the Postal Service is required to fund its own operations, but bureaucracy and inefficiencies sometimes can rule with an iron fist. This is a problem, and the President's criteria for reform will certainly help us as lawmakers cut through some of the red tape and remove unnecessary hurdles.

Postal reform is a challenge, but it is also an opportunity to change a government entity for the better through transparency, flexibility, and accountability, the Postal Service can be successful.

Again Mr. Chairman, I want to thank you for holding this hearing today. I am very confident that each of the witnesses today will provide this panel with information that will allow us to help the Postal Service become a success well into the 21st century. I look forward to working with you and all the members of this panel to draft legislation to that end. Thank you.

Mr. MCHUGH. I appreciate the gentlelady's presence and her interest and hard work on the committee.

Next, a fellow New Yorker who has dual zip code residencies, both in the greater New York area and also in the even greater New York area of Blue Mountain Lake in my district, Mrs. Maloney.

Mrs. MALONEY. I would like to thank Chairman McHugh from the great State of New York for all of his efforts, along with Ranking Member Danny Davis, who is the founder of the Postal Caucus, as well as Chairman Tom Davis and Ranking Member Waxman.

I would also like to really thank all of the industry representatives today, and a very special welcome to one of my constituents, Ann Moore, who happens to be chairwoman and chief executive officer of Time Inc. We are very proud that you are here today. I believe she is the first woman to hold this important position and that is an important role model to women in general. I know how active she has been in the PTA and the civic fabric of our city, so we appreciate that.

We are here today to review the Commission's recommendations, but I do want to note that the Postal Service is the second largest civilian employer in the Nation, employing well over 800,000 talented and dedicated workers. The mail industry is 8 percent of our GDP, a $900 billion industry that includes not only the Postal Service, but also 9 million individuals in the private sector.

I also have the honor of representing a large part of the magazine industry, which is enormously important both to the economy of New York, and I would say, the entire country. These are not jobs that go overseas. These are highly paid jobs that are important to our economy. I mentioned that I just came from a hearing with Chairman Greenspan from the Federal Reserve. We were talking about the 3 million jobs lost in the past 3 years. So maintaining jobs in our country is a very important social goal.

I do want to note that as much as we appreciate magazines, they entertain us, they educate us, but because of the escalating cost of the mail, a number of magazines in the district that I represent have folded: Mademoiselle, one that I used to read in my youth, Mode, Brill's Content, and Industry Standard. These are magazines that contacted me. There may have been more that folded, but these are several magazines that folded in the recent 3 years. The reason that they gave was the escalating cost. So by keeping postal rates affordable, publishers, individuals and industries can continue to use the Postal Service, whether it is to send a letter to a friend or a magazine.

Today, we have the opportunity to hear the responses we have heard in two former hearings, their response to the Commission's recommendations, and to hear how the postal reform recommendations will affect their businesses, and very importantly, their ability to employ citizens in our communities. So I look forward to the hearings, and again I congratulate particularly Chairman McHugh and Danny Davis. This is an issue they have worked on for at least 5 years, so I hope we can come to a conclusion this year.

Thank you very much.

Mr. MCHUGH. I thank the gentlelady for her hard work.

Next, the gentleman from Pennsylvania, who again asked voluntarily to be on this special panel. We deeply appreciate that. It

demonstrates his concern and his devotion to the issue, Mr. Murphy.

Mr. MURPHY. Thank you, Mr. Chairman. I appreciate the opportunity to be here today and to serve on this panel.

There is no better time than the present to thoroughly examine the health and viability of the U.S. Postal Service. It has been said many times by both members of this panel as well as other witnesses testifying before it, but it bears repeating, that if the Postal Service is to continue to serve the public in the future as ably as it has in the past, changes must be made.

The Postal Service and the private mailing industry, postal employees and the public, cannot afford to wait any longer for meaningful action to be taken. I want to commend the President for taking the initiative and highlighting the pressing need for postal reform by establishing the President's Commission on the Postal Service, as well as thank this panel.

I need to offer thanks to the many workers of the U.S. Postal Service who have themselves offered ideas from the inside to improve efficiency, reduce waste, and enhance consumer services. I am looking forward to hearing testimony today, particularly from Mr. Smith, as you may know, Dan Sullivan, the president and CEO of FedEx Ground who really is the reason why you are so successful. [Laughter.]

I hope he reminds you of that daily. He did not pay me to say that today. [Laughter.]

It is extremely helpful for me to hear from those who are involved with private delivery, as well as those who are involved with the Postal Service, to hear ideas come from the inside. I certainly encourage all services to continue to get us that kind of information, which helps us make the best of good organizations.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman.

Next, another New Yorker. You can never have too many New Yorkers, the gentleman from the great city of New York, my good friend, Ed Towns. Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman. Let me thank you for holding this hearing. This is our third hearing. This has been an informative process, and Subcommittee Chairman McHugh and also Mr. Davis should be really commended for their hard work. I salute you for it.

I would also like to recognize one of our witnesses here today.

Mr. MCHUGH. Because he always says so many important things, the audience is expressing an interest, they cannot hear you. Could you swing that mic closer?

Mr. TOWNS. Can they hear me? That's a new one.

Mr. MCHUGH. Yes, it is. [Laughter.]

Mr. TOWNS. Thank you, anyway. [Laughter.]

Mr. MCHUGH. You can repeat the nice things you said about me. I don't care about the rest of it. [Laughter.]

Mr. TOWNS. I would also like to thank, of course, Ann Moore, the chairman and CEO of Time Inc. Carolyn Maloney, my colleague, said some nice things about her and claimed her, but her daughter goes to school in her district, but she actually lives in my area, so

I want you to know that. I want to make that distinction. She is Kings County. [Laughter.]

It is always good to have someone from Kings County appear before this committee. You are always welcome. I want you to know that. I have to make certain that I top Carolyn Maloney. [Laughter.]

Though it has been widely reported and often repeated about the fact that we must reform, I do not want to lose track here about what we are supposed to be doing because reform is neither positive or negative. We want to talk about some positive kind of reforms. When you say "reform," you have to tell us what you are going to do. When we hear "reform" around here, we get all excited.

What I have learned over the years that I have been around is that when you say "reform" around here, that means cut your budget. We do not want to be involved in that. It is like my dad used to tell my brother and I about prayer. He said, "Son, if somebody says they are going to pray for you, you need to try and find out what they are going to say." [Laughter.]

He said, "the prayer is neither positive or negative. They might pray that they break your neck." So we have to make certain that the changes that we make here are positive, because I think that is more important than anything else, just not to reform, but to make certain that we reform in a positive kind of way.

So far there seems to be nearly unanimous agreement on some of the issues. We all agree that outstanding issues related to the escrow must be resolved quickly so those funds can be used to address long-term liabilities like retiree health care and capital improvements.

There is also widespread agreement that the Treasury Department should take responsibility on military pensions. That is something that I think should happen. This position has been adopted by the Presidential Commission, members of both sides of the committee, union representatives, and according to our witnesses' testimony, they also agreed with it as well, by the mailing industry as well.

The only stakeholder not to adopt this position so far has been the administration. Given such support from a diverse array of interests, I hope that the administration understands that there is no negotiation on this point. This is a point that we will not back off of. As one union official noted, the Postal Service will not be a cash cow to reduce the deficit.

But beyond these issues, some divisions have emerged. On paper, the objectives set out by the Commission seem reasonable and fair. Just like any nonprofit organization or business, why would we not want to implement the best practices in postal operations?

Additionally, as a public institution, it would seem to make sense that Postal Service operations are transparent and accountable. The difficulty arises when we have to translate these principles into actual legislative language. Given the slow and steady drumbeat of consensus that is beginning to emerge on these issues, I remain hopeful that we will be able to reach consensus on some of these difficult issues.

The long-term viability of the Postal Service and its workers, our constituents, and the millions of employees in the mailing industry

depend on us. We must not let them down. I look forward to hearing today from the witnesses on why they believe these reforms are critical and why we need to act on these changes now.

Thank you, Mr. Chairman. On that note, I yield back.

Mr. MCHUGH. I thank the gentleman, and I listen to his words very carefully. He should listen to mine. Depending on how he votes, I will pray for you. [Laughter.]

Next, I am honored to yield to the gentlelady who, again as we all have, volunteered to be on this panel, the gentlelady who helped with chairing one of our hearings and has done a great job, from Tennessee, Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman. I will be very brief, and look forward to hearing from our panelists.

I want to thank each and every one of you for taking your time to be here today. I especially would like to extend a welcome to Mr. Smith. And it is always a pleasure to see someone from Tennessee and from our district, Mr. Critelli, who has many employees that are in our district and are constituents. We welcome you. We look forward to hearing from you, and also learning from you lessons learned, best practices that we are looking forward to seeing implemented in the Postal Service as we address the need for reform and equipping the Postal Service for 21st century delivery of service. We thank you and we appreciate your contribution.

Mr. MCHUGH. I thank the gentlelady.

Next, a gentleman who cares enough about this issue to even in the month of February, no offense, Mr. Ranking Member, Mr. Davis made the journey from Virginia to Chicago. I will allow you to make the judgment as to what kind of devotion that shows on an issue.

Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman.

When Danny Davis promises if you come to Chicago he will give you good weather in January or February, please beware. [Laughter.]

You know, "fool me once, shame on him; fool me twice, shame on me." But I must admit, I have not been involved in this postal issue as long as people like the chairman and the ranking member and other members, but like so many here, I volunteered. I asked to be on this panel because of the great impact the Postal Service has on our economy and every single American.

The Postal Service would fail if it were not for its largest customers that we see sitting here today, and their input on the future direction of the Postal Service is of utmost importance. I am glad to have those leaders here to talk about those customers today. I have read all your testimony and I look forward to hearing that and then asking questions at the end.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman. Again, I have found, where I am from, the weather in Chicago is wonderful. [Laughter.]

But it was really great that you made the effort to be there. We deeply appreciate it.

Next, a gentleman, and last I believe, only by order of congressional procedures, a gentleman who is not a member of this panel, but who has previously been a member of the full subcommittee.

I will tell you from our personal conversations, he is one of the most interested and concerned members on this issue, the gentleman from Connecticut, Mr. Shays, who wanted to be here and particularly make a statement about one of our panel witnesses, who has a somewhat passing interest in the great State of Connecticut.

Mr. Shays.

Mr. SHAYS. Thank you, Mr. Chairman.

Mr. Chairman, not being a freshman, I certainly did not volunteer for this committee, having had the opportunity to do some of this work in the past.

I am here, frankly, to thank those who have volunteered, and to thank you, Mr. Chairman, and Danny Davis and our ranking member, and in particular the chairman of the full committee, Tom Davis. This is a hugely important issue. I think it speaks volumes that we have such a distinguished group of panelists.

I do not intend to ask questions, but I do intend to stay for the first round of statements from all of our panelists. I want to thank them, each and every one, for being here. I do want to particularly thank Michael Critelli. He has been laboring on this issue for an extraordinarily long time and has sought to make this bipartisan. Frankly, that is the only way it is going to succeed, and not just management, but with unions as well. Michael, I just thank you for what you have done.

I also want to say something else to this full committee and to the audience here as well. Pitney Bowes made a decision in Stamford, CT, which is a corporate mecca, frankly, of the United States, in my judgment, to move some of its operations to the old industrial city of Bridgeport, which I also represent. He did it without any fanfare. He just knew it needed to happen. He could have moved some of these folks to suburban areas. For that, as well, Michael, I just thank you for what your company is doing. It speaks volumes for who you are, but it also speaks volumes for the commitment of your wonderful company to the well-being of our country and to the district that you are in.

Thank you for allowing me that opportunity. I will, as recompense, stay for all the statements since I have been allowed to make a statement.

Thank you.

Mr. MCHUGH. I thank the gentleman for being here and for his leadership on this full committee, and his deep concern on this issue.

It is now time for me to have the honor of introducing our witnesses. I can assure the audience that these captains of industry are not entirely accustomed to sitting for as long they patiently have listening to a bunch of politicians make statements. No American should have to go through that. [Laughter.]

But they did, and I am deeply appreciative for it. I want to introduce them to you.

These are partners in our effort at postal reform. If you look at the interests that they represent, it is a remarkable one and one that perhaps some would argue places their corporate interest behind the national interest. That is about as high a praise as I think anyone could assess to any individual.

The gentleman from Connecticut just introduced Mr. Mike Critelli from Pitney Bowes. You heard about his interest in the State of Connecticut, but they have long been a partner in this initiative. He has done yeoman's work in creating the Mailing Industry CEO's Council, which has been instrumental in trying to move forward this issue. Ms. Ann Moore, I don't know where she lives, I don't know where she works other than New York, and that is all I care about, but obviously Time Inc. is a true giant, not just on the corporate scene in the United States, but on the world stage. We are deeply honored to have her here today.

Bill Davis from R.R. Donnelley, from the great city of Chicago. Mr. Davis and his company were one of the earliest partners with this original subcommittee and now panel, in trying to move in this area. We are deeply, deeply appreciative of his efforts.

Mr. Nigel Morris of Capital One. Mr. Morris represents a company that has enormous financial interest in the U.S. economy, in the world economy. His recognition of this interest as one of great importance is demonstrated in his presence here today. We are deeply appreciative of that.

In particular, I want to especially welcome and thank Fred Smith from Federal Express. Fred has been a steadfast partner, a supporter throughout our most early efforts at postal reform in the mid- and late–1990's. And as he has done here today, when you have a chance to hear his testimony, and I hope you get a chance to read his full statement, has provided constructive, honest, credible, reasonable recommendations. He is a competitor of the Postal Service. This is a gentleman who started a company from nothing; who has become an enormous example of what the American opportunity can present to people with initiative and the willingness to work hard, and who still at the end of the day as a U.S. citizen recognizes the importance of a viable Postal Service. Fred, a particular welcome and thanks to you.

I would state, and I have always felt it was somewhat of an anomaly, that Members of Congress should take the oath of telling the truth, but our committee policy is that all witnesses should be sworn in prior to their testimony. So if you would please all rise and raise your right hands and answer the following question.

[Witnesses sworn.]

Mr. MCHUGH. And they have so answered in the affirmative.

I am going to ask the witnesses to present their testimony based on the list that I have in front of me. I think it generally goes from our left to the audience's right. Note that without objection, all of your written testimonies will be entered in their entirety to the record. Without objection, so ordered.

With that, to the extent it is possible, we are not going to run red lights on you, but clearly your time is probably far more valuable than ours, if you could try to summarize your comments, it would be greatly appreciated.

With that, Fred Smith, chairman and chief executive officer of FedEx, Federal Express. Fred.

STATEMENTS OF FRED SMITH, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FEDEX; ANN MOORE, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, TIME, INC.; MICHAEL CRITELLI, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, PITNEY BOWES; WILLIAM DAVIS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, R.R. DONNELLEY & SONS; AND NIGEL MORRIS, CO-FOUNDER AND VICE CHAIRMAN, CAPITAL ONE

Mr. SMITH. Thank you very much, Mr. Chairman. As you suggested, I will submit our testimony for the record and just summarize it.

On behalf of hundreds of thousands of FedEx shareowners and over 220,000 FedEx employees in the United States, we appreciate the opportunity to comment on this important initiative. As you noted, we do support USPS transformation and modernization so it can survive and prosper. We have supported reform legislation which you championed in previous Congresses. We will submit detailed comments on a new bill when it is ready.

FedEx is no stranger to the requirement to modernize and meet market conditions. As Mr. Murphy mentioned a moment ago, we have become a major player in the ground parcel business, in the freight business. We have become an enormous presence in the international trade of the United States and the world. All during those diversifications and new initiatives, our domestic express business has declined in the sector that can be transmitted electronically.

So we have seen this as a company, and we have seen it observing the Postal Service and industry and technological development, and as a supplier to the Postal Service. So we strongly believe that the Postal Service must transform. We are in the midst of a truly unprecedented phase of the Information Revolution, with the Internet and the other remarkable technologies as Chairman Davis mentioned at the onset. To properly transform, we feel that the USPS needs flexibility and incentives. General Potter has testified to this committee quite succinctly that his management needs the flexibility to manage the business. The right incentives to managing any business are critical, whether it is FedEx or the USPS or any other enterprise.

Certainly, the obstacle is not a lack of good people at the USPS. We have been uniformly impressed with the quality of the folks that we deal with at USPS and their executives in particular. But quite frankly, we could not have transformed and become a $25 billion business had we had the same restrictions and disincentives of a monopoly that currently shackle the Postal Service.

The Presidential Commission, as was noted a moment ago, recommended that the best practices of the private sector be applied to the USPS. Again, that means flexibility and incentives. The Postal Service regulatory regime needs to transform, and we support the guarantee of universal postal service, and at the same time appropriate restrictions on cross-subsidy and unfair competition where the Postal Service competes with private companies.

The key to this regulatory transformation is to have separate management and governance. Congress should set the scope of the universal service that you desire, and then the appointed regulator should enforce that scope. The regulator should set the monopoly

at a level that is at a minimum needed to fund universal service, and this should be an economic and not a political question. The regulator should set price caps for non-competitive products.

On the other hand, the management of the USPS, in our opinion, should set the wages, other input costs, manage retained earnings, and so forth. The regulator should then set public policy objectives for the USPS management to manage against.

We strongly believe that regulatory transformation can result in better universal service and appropriate controls on unfair competition that are better than the current law. FedEx also supports the USPS on some of the issues that have been discussed today: military pensions, the matter of the escrow account and so forth.

In short, we think that the USPS at the end of the day in this legislative process should end up being a much more business-like enterprise with less political agendas, with the USPS board empowered to oversee an appropriate transformation.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Smith follows:]

Before the
Special Panel on Postal Reform and Oversight
of the
Committee on Government Reform
United States House of Representatives

Prepared Statement of
Frederick W. Smith
Chairman, President, and Chief Executive Officer
FedEx Corporation

February 11, 2004

FedEx supports modernization and transformation of the United States Postal Service. FedEx worked closely with the committee in the past to develop H.R. 22 and H.R. 4970, and we continue to believe that this legislation represents a sound and balanced update to the Postal Reorganization Act of 1970. For reasons well described in the recent report of the President's Commission on the Postal Service, the Postal Service must be transformed into a fundamentally more flexible and responsive organization if it is to survive and prosper in the shifting social, commercial, and technological conditions presented at the start of the twenty-first century. At the same time, the regulatory framework must be reshaped to protect and promote a universal postal service suited to the needs of citizens in the Information Age. At FedEx, we look forward to working with the committee in addressing these challenges.

I am testifying today on behalf of the management and over 200,000 employees and independent contractors who make up the FedEx family of companies. For them and for myself, I would like to thank the committee for this opportunity to present our views on reform of the nation's postal laws. I am keenly aware that many members of the committee have worked long

and hard to find a formula for postal modernization. Chairman Davis, Mr. Waxman, Mr. Burton, and Mr. Davis of Illinois have been leaders in this bipartisan effort, and we at FedEx are grateful for their contributions. Chairman McHugh, however, deserves the particular thanks of all participants in this process. As the prime mover of postal reform for eight long years, he has combined the patience of Job with the wisdom of Solomon and the eternal optimism of a Cubs fan. It is a particular pleasure to return to the topic of postal reform and find Chairman McHugh still holding the gavel.

In four previous appearances before the committee, I have discussed in some detail the key concepts and specific provisions found in past legislative proposals, including the inherent difficulties in competition between public and private enterprises, appropriate mechanisms for ensuring universal service, division of postal products into non-competitive and competitive categories, reasonable limits on pricing flexibility for each category of products, proper bounds for market tests of new postal products, the scope and administration of the postal monopoly, equitable access to the mailbox for all operators, equal application of non-postal laws to the Postal Service and private companies, impartial administration of postal laws, Postal Service entry into new markets, the role of the Board of Governors, and inadequacies in U.S. international postal policy and the Universal Postal Union. I am happy to acknowledge that the last version of this legislation (H.R. 4970) addressed most of the points raised in my testimony. I will be glad to comment in similar detail on a new legislative proposal when it is ready.

Today, I would like to focus more generally on how the evolving commercial environment has impelled profound changes in the way we at FedEx do business and why, in my

view, similarly elemental changes must be considered for the Postal Service and the postal regulatory framework generally.

THE TRANSFORMATION OF FEDEX:

FROM DOMESTIC EXPRESS TO GLOBAL TRANSPORTATION SOLUTIONS

As the Postal Service, the Presidential Commission, the Comptroller General, and many others have pointed out, the delivery services sector is changing rapidly and fundamentally. Postmaster General Potter has rightly called this a period of "structural change." For the Postal Service, the key barometer of change is its core product, First-Class Mail. First-Class Mail has dropped by more than 4 percent since 2000. Moreover, as Governor Fineman, chairman of the Postal Service's Board of Governors, has pointed out, the product mix of the Postal Service is shifting inexorably. This year First-Class Mail crossed a major psychological barrier as it fell to less than half of total mail volume (49 percent, as opposed to 50 percent in 2000).

Virtually all observers have emphasized to this committee that the Postal Service needs greater flexibility in operations and pricing. I agree with these prescriptions. To underscore this point, I would like to describe briefly what has happened at FedEx since I last testified in March 2000.

Like the Postal Service, we have been challenged by the decline of old technologies, the rise of security concerns, and the turmoil of economic dislocations. Looking back, the decade prior to 2000 was a golden age. Our express shipments increased by almost 150 percent, more than 9 percent per year. During the same period, First-Class Mail grew at an average annual rate of 1.5 percent. Then, from June 2000 to June 2003, our domestic express shipments *declined* by

more than 8 percent. This decline is almost three times the decline in First-Class Mail over the same period.

In response, we initiated a tough program of cost containment. We froze hiring in most areas, reduced bonuses, cut discretionary spending, and lowered capital spending. This year FedEx Express offered voluntary early retirement and voluntary severance incentives to many employees based in the United States. As a result of such measures, FedEx Express has significantly fewer employees today than it did in 2000. And I am happy to report that during this difficult period FedEx Express has not had to lay off a single employee.

Cost reduction, however, is only the beginning of the story. In 2000, we extended the FedEx brand to a broad and integrated range of ground, freight, and logistics services. This initiative represented far more than a "rebranding" exercise. We have moved FedEx's center of gravity away from the familiar world of overnight express services. Today, the FedEx family of operating companies consists of FedEx Express, FedEx Ground, FedEx Freight, FedEx Custom Critical, FedEx Trade Networks, and FedEx Supply Chain Services. We have also increased our participation in global markets enormously. Today, FedEx delivers shipments of any size and related information to virtually any place in the world in a range of circumstances best suited to the needs of our customers. In essence, our business has become one of enabling customers to optimize global supply chains.

This transformation has already had dramatic consequences for our company. In three short years, the share of corporate revenues provided by the U.S. domestic express package business has dropped from 55 percent to 41 percent. FedEx International Priority package revenue has risen from one-quarter to one-third of our overall express business. In short, the

FedEx that I represent today is not the same FedEx that I represented in 2000. This transformation is still unfolding. We are continually looking ahead for new ideas and new partners that will allow us to better meet the demands of an ever changing marketplace -- before someone else beats us to it.

THE TRANSFORMATION OF THE POSTAL SERVICE: GREATER FLEXIBILITY AND STRONGER INCENTIVES

Under the leadership of Postmaster General Potter, the Postal Service has made truly impressive strides in cost containment. In other areas as well, the Postal Service is carrying through on the many improvements outlined in the Transformation Plan. I am very pleased to commend such progress by a fellow CEO in our business.

For the Postal Service, however, as for FedEx, I believe that cost containment and incremental operational improvements will prove insufficient to ensure survival. If the Postal Service is to prosper over the next decades, it will require profound institutional transformation. The gale force winds reshaping global commerce are blowing at Postal Service headquarters no less than at our own. The implications of these forces must be faced squarely by Congress, mailers, and the management and employees of the Postal Service.

Peter Drucker has estimated that "[t]he Information Revolution is now at the point at which the Industrial Revolution was in the early 1820s." According to Drucker, the computer and other gadgets of the Information Revolution have so far done little more than improve processes that were already going on. The real revolution is only just getting underway. It is the internet, says Drucker, that is destined to reshape life in the global village in the same way that

the railroad reshaped all aspects of society in the middle of the nineteenth century.

In broad terms, Professor Drucker is surely correct. The influence of the internet is already so pervasive that it is difficult to recall how recently it was introduced into the mainstream of society. The majority of American households were not connected to the internet until late 2001. Today, some three-quarters of American households are connected in major cities. Even so, outside the wealthiest neighborhoods and college dorms, broadband connection to the household is still the exception. And outside the United States, where the internet is less ubiquitous, almost all nations have made expanding internet connectivity a top governmental priority. We are only just beginning to see the implications of the internet for society in general and for the Postal Service in particular.

Viewed from this perspective, the future of first class correspondence must be regarded as extremely precarious. Proliferation of high speed connections will likely also reduce demand for the physical distribution of advertisements, catalogs, and magazines. It takes no crystal ball to recognize that such shifts in the demand for traditional postal services will necessitate a radically different Postal Service organization. How different will depend upon on how well the Postal Service responds.

As presently organized and regulated, the Postal Service is ill-equipped to undertake the needed transformation. As you know, in the last two years, FedEx has begun supplying air transportation for several Postal Service products. This has been our first extensive working relationship with the Postal Service, and we have been extremely impressed with the professionalism of Postal Service managers and the scale of its operations. At the same time, this relationship has allowed to us to understand better the institutional restraints handicapping the

Postal Service. So I can say now with the benefit of first hand experience that it is the system, not the people, that poses the greatest obstacle to the future of the Postal Service.

When the Postmaster General says, "Management needs the flexibility to manage" he is not repeating a pious nostrum; he is identifying the basic tool necessary for the survival of the Postal Service. Likewise, in an earlier hearing, Governor Fineman insightfully put his finger on a second critical element of postal transformation: incentives. The Postal Service needs both the flexibility to adapt to the demands of its customers and the incentives to do so. These are the two necessary ingredients to transformation of the Postal Service.

Consider how difficult would have been the changes at FedEx that I have just described without the flexibility and incentives enjoyed by a private company in a competitive market. Imagine that, three years ago, the directors of FedEx were replaced by a politically appointed board of governors. Imagine that FedEx was required to obtain regulatory approval before offering new services. Imagine that we were forbidden from consolidating offices and operational facilities in response to shifting demand. And, worst of all, imagine we are granted a legal monopoly over domestic express shipments, a "privilege" that would send a loud and clear message to our employees: "Relax, FedEx will get the business for now whether you satisfy the customer or not." Under such circumstances, can anyone imagine that FedEx -- even with its talented and dedicated management team -- could have managed the changes of the last three years? I cannot.

The Presidential Commission urged the Postal Service to "[apply] the best practices of the private sector to delivering the nation's mail." No doubt, this is the right objective, but it is an objective that can be achieved only if the Postal Service has the management flexibility and

incentives of the private sector. If the Postal Service is not granted such flexibility, and lacks such incentives, then the probable fate of the Postal Service is to wither and decline. The market is changing too quickly to predict any other outcome with assurance.

THE TRANSFORMATION OF POSTAL REGULATION:
THE FUTURE OF UNIVERSAL POSTAL SERVICE AND FAIR COMPETITION

Of course, as members of the committee are aware, imbuing postal management with flexibility and incentives sufficient to emulate the "best practices of the private sector" sounds good in theory, but it also raises many thorny policy issues that cannot be dismissed out of hand. Many will ask, what if the Postal Service uses managerial flexibility to close a post office in my town? To cross subsidize competitive services from monopoly revenues? To curtail delivery services in my neighborhood? To raise postage rates critical to my business? To go into competition with my company? Indeed, suppose the Postal Service uses managerial flexibility to pursue a disastrously unwise business venture?

In the first place, it should be noted that none of these objections truly obviates the basic case for conferring on the Postal Service greater flexibility and stronger incentives. In times of fundamental change -- such as we are living through now -- the ability to respond and restructure is necessary to institutional survival. The whole purpose of the changes at FedEx has been to enable us to better serve the present and future needs of as many customers as possible by reducing costs and improving services. So, likewise, there is no reason to believe that the Postal Service, faced with proper incentives, will abandon customers or curtail needed services. On the

contrary, there is every reason to believe that the Postal Service can and will improve the level of services provided.

I realize, however, that this general observation is hardly adequate. Many will argue that postal service remains so important to the country that we must not merely provide proper incentives for continued universal service, we must *guarantee* universal service at an affordable rate for all Americans.

I agree. Let me be clear. I support universal postal service. Every citizen in every part of the nation should have access to basic, affordable postal service. There is no reason that I can think of why the basic stamp price cannot remain uniform and affordable throughout the nation for as far into the future as we can see. "Should the United States assure universal postal service?" is not the question so far as I am concerned. But "What is the most efficient way for the United States to guarantee a level of universal postal service consistent with our national needs?" is a legitimate question that proponents of universal service need to address seriously and quantitatively. More particularly, any legislation must address the corollary question: "How can we give the Postal Service the maximum level of managerial flexibility and appropriate incentives while ensuring a level of universal service appropriate to the needs of the public?"

The other great specter raised by managerial flexibility at the Postal Service is the shadow of unfair competition. As I have said many times, FedEx will not support a bill that allows the Postal Service to raise rates in non-competitive markets and use the funds to lower rates in competitive markets. Nor will we will support a bill that allows the Postal Service to use governmental status for commercial gain or convert assets of the United States into cash for buying into competitive markets. The "firewalls" found in past reform proposals remain crucial

to our support for postal legislation. At the same time, FedEx has supported the right of the Postal Service to compete fairly. Indeed, I remind the committee that in years past FedEx was one of the lone voices arguing that over the long term Postal Service management needed the flexibility to enter new markets reasonably related to current business, a managerial option Postmaster General Potter pointed to in his recent testimony. In the past, we accepted this possibility provided the Postal Service competed on a level playing field and maintained structural separation between postal and non-postal businesses. We still think this is a concept worth considering.

While all reasonable persons must concede that concerns over the quality of universal service and fair competition are both fundamental and legitimate, these concerns are not irreconcilable with giving the Postal Service the managerial flexibility and incentives necessary for fundamental transformation. Indeed, I firmly believe that postal transformation, managed correctly, can *improve* the quality of universal service available to all Americans. I also firmly believe that postal transformation can be integrated with regulatory improvements that will, without a doubt, provide *more effective* safeguards against unfair competition than exist under current law.

To take the necessary steps with such assurance, we need a transformation of the postal regulatory framework comparable to that which postal operators must undergo. In his recent testimony, Commissioner Omas, chairman of the Postal Rate Commission, put his finger on the key principle running like a thread through the Presidential Commission's report: strict separation of managerial and government functions. The Postal Rate Commission, or its successor, must make the necessary judgments about public interest goals which the Postal

Service -- and any other providers of basic postal services -- must fulfill. After that, Postal Service management should be free to manage to the public interest objectives set by the Commission.

In this regard, the Presidential Commission has made several useful suggestions and some less useful. The Commission proposed that the postal regulator should be authorized to make adjustments in the scope of universal service and the breadth of the postal monopoly. In my judgment, the scope of universal service is both a political and a technical issue. The broad parameters of universal service embody social policy. They should be determined by Congress in legislation, not by a regulator. Precisely how these parameters are applied in a given community -- for example, whether the time has come to close a post office that has been maintained for largely social reasons -- is a more technical matter that should be committed to the regulator.

The postal monopoly is a different animal. Whether or not universal service should be funded in part by a postal monopoly is a decision for Congress to make. Personally, I think that granting a monopoly to any commercial enterprise is a mistake. A monopoly induces inefficiencies and disincentives that outweigh any possible benefit. The biggest victim of the postal monopoly is the Postal Service. Nonetheless, whether to employ a monopoly as a funding mechanism is a Congressional decision, much like a decision on tax policy. Assuming Congress approves the continued use of a postal monopoly, it should, at a minimum, put in place a statutory ceiling such as that proposed in H.R. 4970. Underneath this ceiling, the breadth of the monopoly needed to support a given level of universal service is a technical, economic judgment that is best committed to an impartial and expert regulator. The basic rule should be that the postal monopoly should be no more extensive than needed to finance universal service.

The Presidential Commission also proposed giving the postal regulator more questionable powers. While I agree that the postal regulator should be able to limit the total revenue generated from non-competitive postal markets, I do not see any reason why the regulator should second guess postal management's decisions about one particular cost input, the wages of employees. Once the regulator has put reasonable limits on non-competitive postage rates, using price caps or some other means, the Postal Service should be free to manage its cost structure like any other commercial organization. The same may be said about regulatory oversight of retained earnings, another proposal by the Presidential Commission. In my view, the appropriate level of retained earnings should be determined by the managers and owners of the Postal Service, not by a regulator whose task is to ensure the standards and affordability of universal service.

The principle that managerial and governmental functions should be clearly separated also provides the proper framework for addressing issues raised by last year's postal financing law. Since military pensions are clearly a responsibility of government, not an operational expense, they should be a liability of Treasury, not the Postal Service. Similarly, since structural transformation of a commercial organization like the Postal Service is more a managerial than a governmental problem, introducing Congressional control over an escrow account, funded by possibly unnecessary rate increases, may not be the best way to facilitate the long term survival and prosperity of the Postal Service. The Presidential Commission urged Congress to consider legislation to make the USPS Board more business-like and less political. While I do not necessarily agree with the specifics of the Commission's proposal to reorganize the Board, the Commission did identify the proper focus for Congress: modernize the USPS Board and then let it oversee the transformation process.

CONCLUSION

The Postal Service's April 2002 Transformation Plan began, "We live in challenging times." Indeed we do. At FedEx, in the last three years, we have put enormous effort into understanding these challenges and transforming our company to meet them. As many observers have pointed out, it is time for Congress to undertake a transformation of the Postal Service and the postal regulatory framework that is at least as fundamental as that underway at FedEx. We look forward to working constructively with the committee and with the Postal Service to make this transition a success for both the Postal Service and for the nation.

Thank you.

Mr. MCHUGH. I thank the gentleman, again, deeply appreciate his courage and his leadership on this issue.

I would say to the panel, I apologize. You can hear. We have at least one, perhaps two votes. If you could please bear with us and smoke them if you have them, and we will return as soon as we can.

With that, we stand in adjournment.

[Recess.]

Mr. DAVIS OF VIRGINIA. The meeting will reconvene. We are coming back. We have Ms. Ann Moore, the chairman and chief executive officer of Time Inc. as our next witness. Ann, thanks for bearing with us. It is just a pleasure to have you here today.

Ms. MOORE. Thank you, Chairman McHugh, Ranking Member Davis, Chairman Davis, Congressman Waxman and members of the panel, for this opportunity to discuss the crucial issue of reforming the U.S. Postal Service.

As you have heard, I am Ann Moore, the chairman and CEO of Time Inc. We are the world's largest magazine publisher, with 134 magazines including Time, People, Sports Illustrated, and Fortune. I have been involved with postal reform issues for a long, long time, almost as long as Chairman McHugh. I, like Congressman Schrock, volunteered to work on this back when I was president of People.

There is no issue more critical to the magazine business and to magazine readers than the future viability of the postal system. The great majority of our readers depend upon the postal system to deliver their magazines. We need to work together, obviously, to ensure that this can continue over the long term. It affects everybody from the mom who reads Parenting to the sports fan who reads Sports Illustrated.

The core value of the post office has always been reliable, affordable delivery of the mail to every American home. We know that Congress wants to maintain this goal. We have a tremendous opportunity to pass meaningful, comprehensive legislation at this time, and we are all committed to working with you to get it done.

The current Postal Service business model, as we have all heard this morning, is not sustainable in a climate of expanding addresses and declining mail volume. We really applaud the efforts of Jack Potter to reduce Postal Service costs. But reducing costs alone will not solve the problem. Really broad and sweeping change is required.

President Bush and the Treasury deserve thanks for creating the Presidential Commission to help address these issues, and we do support the report's five core principles. However, it is also crucial that a rational rate cap system be put in place by Congress. The dramatic rate increases we have seen are simply not acceptable. As a result of rate increases in recent years, postage expenses have become our single biggest line item at Time Inc. This year we will spend more than $500 million on postage.

This surprises people, but we actually spend more on postage than we do on paper or printing. We spend more on postage I think than any other company in America. So we are acutely aware that postage costs have been going up at a rate that far exceeds the rate of inflation. These statistics are documented in our written testi-

mony, but in 2001 and 2002, we experienced three rate increases within an 18-month period. If you go back to 1986, magazine postage costs have gone up by 220 percent, nearly double the rate of inflation.

From our own experience, we know that these rising postal costs drive mail volume out of the system, which compounds their problem. Today's rate system fails to provide the Postal Service with strong incentives to hold down costs. It also fails to provide mailers with predictable rates. That is why Congress needs to institute a rational rate cap system. Give us predictable rates and we will give the Postal Service more volume, from our current magazines to all the new ones I would like to launch. We have many creative ideas on the drawing board, magazines that consumers tell us they want. But if I cannot predict the future costs of mail and the long-term cost of a new launch, I am not able to launch. I do not need to tell you that ventures like new magazines create jobs. We have only 15,000 employees at Time Inc., but if you count all the suppliers that depend on us, from the paper mills to the printers to the mail houses, we are part of the 9 million workers who are part of our mailing industry. A little-known fact is that one subscription, by the way, to a weekly magazine can generate over 90 pieces of mail. That is real growth and that is what the Postal Service needs.

For all of these reasons, it is crucial that rates be capped to an inflation benchmark and that rates be based on cost, kind of a pay for what you use. It is a good business principle. Of course, price caps must not be met at the expense of service. Any reform bill must include service measurement systems and delivery standards for all classes of mail.

Before I conclude, I want to also comment on last year's CSRS legislation. This bill provided much-needed relief for the mailing industry, and I want to thank each of you for getting it passed. That said, the bill as we all know included two problem items that need to be addressed. First, the bill's escrow provision, which forces mailers to pay an additional $4 billion in 2006. This item alone will add another 5.4 percent increase to our postage rates. And second, the CSRS bill also shifts the $27 billion in military retirement costs from the Treasury to the postal system. Since 90 percent of those costs date back to before the establishment of the postal system in 1971, we support transferring that back.

So in summary, Time Inc. believes that the issues challenging the post office are urgent, and they really require bold action by Congress. So we need only three things: predictable rate increases that do not exceed the rate of inflation, a rate cap system; resolution of CSRS escrow and the retirement issues; and finally, service standards for all classes of mail.

I am personally committed to working with you and all interested parties to help implement urgently needed postal reform. I just want to thank you again, Mr. Chairman, for this opportunity to share the views of Time Inc. with this special panel.

[The prepared statement of Ms. Moore follows:]

Time Inc.

Testimony of Ann S. Moore
Chairman and Chief Executive Office
Time Inc.
House Committee on Government Reform
Special Panel on Postal Reform and Oversight
February 11, 2004

Chairman John McHugh, Ranking Member Danny Davis, members of the Special Panel on Postal Reform and Oversight, thank you for this opportunity to share the views of Time, Inc. on the crucial issue of reforming the United States Postal Service. I want to salute your leadership and the effective guidance of full committee Chairman Tom Davis and Ranking Member Henry Waxman. It is on account of your collective leadership that we have this opportunity to pass a meaningful, comprehensive postal reform bill. Time Inc. is committed to working with you to achieve that goal.

I have been involved with postal reform issues for a long time, almost as long as Chairman McHugh. I first went to work on postal reform when I was President of People Magazine. Why would I do that? There is no issue more crucial to the magazine business than the future viability of the postal system. The great majority of our readers depend upon the postal system to deliver their magazines. We need to work together to ensure that this can continue over the long term. It affects all of our readers, from the moms and dads who read *Parenting* to the sports fan who reads *Sports Illustrated.*

Since becoming Chairman and CEO of Time Inc., postal reform has become an even more important priority for me. At Time Inc., we have 15,000 employees who have a vital stake in the work that is before you here in Congress. If you count all the suppliers that depend on us, from the paper mills to the printers to the mail houses, even more peoples' livelihoods are at stake.

We are all familiar with the challenges that confront the Postal Service. Mail volumes are declining while the number of addresses served is growing. Operating under an out-of-date statutory business model that virtually demands that declining volume and revenue be met with larger and more frequent price increases, Congress has an obligation to provide the Postal Service with legislative relief from what the General Accounting Office described as a "death spiral."

Few doubt that the Postal Service is absolutely worth saving. The impact of mail is valued at over $900 billion annually and 8 percent of Gross Domestic Product. Our industry - including paper, card, and envelope manufacturers, makers of automation equipment, direct marketers, printers, publishers and shippers - employs over 9 million workers nationwide. Our products touch every household and business six days a week and provide the communication fabric of our nation. The value of universal access and delivery at reasonable prices is as great as the value of equal opportunity and should not be underestimated.

The success of the Postal Service is also critically important to our company. We spend more on postage than any other company in America. We believe the challenge you confront is urgent and deserves a resolution before the death spiral reaches a crisis that puts at risk the Postal Service's ability to deliver its value to our fellow citizens.

The current business model of the USPS is not sustainable. Time Inc. applauds the efforts of the Postmaster General and the Postal Service's employees to reduce costs, but reducing costs alone won't solve the problem long-term. Broad and sweeping change is required.

President Bush and U.S. Department of Treasury deserve credit for tackling this difficult issue and creating the Presidential Commission to help fashion solutions. The heart of the December 8 Department of Treasury principles is broad and sweeping reform, the development of a more flexible enterprise that is empowered to match the challenges of both today and tomorrow.

We concur with Treasury that best practices should at the core of the new business model. We fully support the recommendations on financial transparency, self-sufficiency and accountability. We agree with the recommendations on management flexibility and have recommendations about the scope and role of the Postal Regulatory Board.

Any government-sponsored monopoly requires strong oversight. It is crucial that Congress put a rational rate cap system in place to prevent unsustainable rate increases.

As a result of postal rate increases, postage expenses have become the most expensive single line item at Time Inc. This year, we will spend more than $500 million on postage.

We are acutely aware that postage costs have increased at a rate that far exceeds any inflation benchmark. In 2001 and 2002, we experienced three rate increases

within an eighteen-month period. Looking back to 1986, Time Inc.'s postage costs have outpaced inflation by more than 60 percentage points.

Out of control postal costs drive mail volume out of the system, compounding the problems this committee seeks to address. The success of postal reform will depend a rate system that delivers a strong incentive to hold down costs and to provide mailers with predictable rates. If I can plan ahead for rate increases, more mail will result - and that is the real growth that the Postal Service needs to survive.

At Time Inc., we have a lot of creative ideas on the drawing board for magazines that consumers tell us they want and that I am itching to launch. If I can't predict the future costs of mail, and thus the long-term cost of a new launch, the risk of building a new magazine is sometimes just too high. Give me predictable rates, and I can launch more magazines, creating jobs not just at Time, Inc., but all the way down our supply chain.

We suggest that rate increases not exceed some inflation-based benchmark. Since approximately 80 percent of the Postal Service's costs are labor, an inflation based rate cap will keep all employees whole against inflation and will allow compensation for productivity increases beyond the rate of inflation. To maintain flexibility for the Postal Service to take advantage of new work-sharing opportunities within a given class of mail, such a cap should be applied at the subclass level. The establishment of this cap should be the responsibility of Congress and not an independent regulatory body. As a statutory standard, we would suggest the elimination of the exigent circumstances exception. The elimination of the exigent circumstances provision will provide a strong incentive for the Postal Service to operate below the rate cap.

We strongly believe that rates should be based on cost, and suggest that each class of mail be required to cover 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, Inc. is a staunch supporter of the criterion that recognizes the 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 this structure, we believe the Postal Service should be free to operate with minimal oversight regarding rates, provided this freedom not come at the expense of service. Prior to the implementation of any rate cap system, the Postal Service must first establish service measurement systems for all mail classes.

We fully support the concept of universal service to every household in America and six day per week delivery. The quid pro quo for this social responsibility is the retention of the lettermail and mailbox monopolies.
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 an 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.

We support Congressional assignment and oversight of several Postal Service functions that the Commission proposed to assign to the Postal Regulatory Board, 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 Postal Service 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.

We are also strongly in favor of promoting worksharing. This concept provides the Postal Service and the mailing community an incentive to seek the lowest possible cost and the highest quality service.
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 need to accomplish this goal. We believe 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.

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 address these problems.

We suggest repealing the escrow provision in S. 380, since the CSRS liability has already been fully funded. Maintaining the escrow provision will cause postage rates to increase unnecessarily. We further recommend that military pension benefits should be transferred to the Treasury. Military pension should be the responsibility of taxpayers, not Postal Service customers. The same should be true for pension benefits earned by Post Office Department employees prior to the creation of the Postal Service in 1971.

The savings accrued from these suggested reforms should be used first to stabilize postage rates until 2008 and second to fund the retiree health care liability. Postal service customers 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, retiree health care issue deserves to be the next priority.

We believe that the issues challenging the Postal Service and the mailing industry are urgent and demand action by the Congress and the Postal Service. The American people deserve bi-partisan action to stabilize and strengthen the postal system. The alternative is a "death spiral" that will severely impact the daily lives of your constituents, the $900 billion mailing industry and the American economy at large. I want to emphasize Time, Inc.'s commitment 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.

Thank you again, Mr. Chairman, for this opportunity to share the views of Time Inc. with this special panel.

Mr. MCHUGH. I thank the gentlelady for her interest, her support, and obviously for her patience and effort to be here today.

Next, as I mentioned, I hope, in my opening statements, a gentleman who represents an organization and who is a gentleman who has been involved in this initiative over the long haul, for which we are deeply appreciative, Mr. Michael Critelli, chairman and chief executive officer of Pitney Bowes.

Mr. Critelli.

Mr. CRITELLI. Thank you very much, Chairman McHugh. I appreciate the opportunity to testify today, and I also appreciate the kind remarks that you and many members of the panel made about me and my fellow CEOs that have worked on postal reform.

Pitney Bowes is vitally interested in postal reform. Let me give you a few facts. We automate mail processing for mailers of all sizes. We have over 1.3 million such mailers in the United States alone. Metered mail, which we invented, is almost one-half of all first class mail, and we collect approximately one-third of all Postal Service revenue. We are the leading manager of corporate and government mail rooms, and we now own the Nation's largest pre-sort business.

More than 90 percent of the mail stream today is sent to or from businesses, governments and nonprofits, and much of it is generated by known mailers who typically use meters or permits for postage. They do much of the work preparing the mail by sorting it, applying bar codes and presenting the mail at designated postal facilities. Our vision of postal commerce includes the Postal Service as a booster of economic growth, not a drain on public resources.

We at Pitney Bowes and the members of the Mailing Industry CEO Council believe that postal reform legislation needs to get done now. Chairman McHugh, you and this committee have led this reform effort for quite a while, and last year the President's Commission and now the administration have joined your efforts to call for enactment of legislation. I am here to pledge today that the members of the CEO Council and I stand ready to assist you in any way possible.

I want to highlight briefly five essential elements of postal reform legislation. First, the mission of the Postal Service is clearly to maintain universal access and universal delivery of physical mail at affordable rates, but it must focus its core physical mail business on growing the mail. More mail means more jobs within the Postal Service, the mailing industry, and other mailers who depend on mail to help them grow. We also believe that the Postal Service should remain a public entity, but implement best practices and right-size the postal network and the work force through attrition opportunities.

Second, legislation should enhance private sector partnerships for the most cost-effective postal system. For example, if work-sharing discounts can drive lower cost, while requiring partners to meet the Postal Service's quality standards, the public, the Postal Service, and the mailing industry will all benefit. These discounts could be for reducing or eliminating costs of mail preparation, payment evidencing, collections, sorting, addressing, or transportation.

Third, the legislation should encourage the Postal Service to embrace technology. The heart of this vision is to encourage mailers

to create machine-readable mail to uniquely marked mail pieces with sender, recipient and other information, and to use available technologies for the highest address quality possible. Bad addresses alone cost the Postal Service over $1.5 billion a year, and mailers several times that. Intelligent mail, as referenced in the Presidential Commission report, is more valuable to the sender because it allows coordination with other services based on when a piece of mail is received. It reduces postal costs, helps the Service manage its workload and it improves mail security because it is traceable. Those who use the mail for terrorism do so anonymously in order to evade detection.

Fourth, postal reform legislation should maintain price stability, while increasing pricing flexibility. Postal rates should not increase faster than the rate of inflation, and productivity should enable rate increases to be constrained below the rate of inflation. Subject to these caps, pricing flexibility is also important, including negotiated service agreements. We believe the Postal Service should be able to pursue dynamic pricing to change postal rates by month, day or even time of day, much like telephone companies or hotels, to promote increased use of mail.

Fifth and finally, the principle is to improve the Postal Service's tools, to manage its employees and its business. The Postal Service should be judged by sound business metrics across all product lines. Performance measures should be based on careful and comprehensive cost accounting and a governing board should be organized around and designed to function in accordance with best practices for financial transparency.

We recognize postal reform is a big job and it will not be solved overnight, but reform legislation in this Congress is essential. We also support congressional action approving the use of CSRS savings currently held in escrow and returning responsibility for funding Civil Service retirement system pension benefits related to the military service of Postal Service retirees back to the Department of the Treasury.

Thank you all very much. I again appreciate the opportunity to present today.

[The prepared statement of Mr. Critelli follows:]

Written Statement
of
Michael J. Critelli
Chairman of the Board and Chief Executive Officer
Pitney Bowes Inc.
Stamford, Connecticut

Before the
Committee on Government Reform
Special Panel on Postal Reform and Oversight

United States House of Representatives
February 11, 2004

SUMMARY

Postal reform is essential because the Postal Service is the linchpin of a 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 almost 9% of the U.S. GDP. Mail is critical to commerce and the way in which the Postal Service conducts its function has a dramatic impact on American business. **Postal reform legislation should**:

Clarify that the mission of the Postal Service is to maintain universal mail service. Universal access and universal delivery are needed at affordable prices. The functions of the Postal Service are accepting, collecting, sorting, transporting and delivering physical mail and packages. The Postal Service should remain a public entity, but become leaner and more flexible. This can be done by implementing best practices and rightsizing the postal network and the work force (through attrition).

Enhance private sector partnerships for the most cost effective postal system. Total mail system costs can be reduced, system efficiency improved, and mail made more affordable through partnerships with the private sector. If the private sector can perform functions better and 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. The Postal Service should continue to benefit from the innovative U.S. mailing industry and not attempt to preempt or compete with private sector participants.

Embrace technology. The Postal Service's Intelligent Mail (I-mail) program will enable each mail piece to be uniquely identified and tracked through the use of data-rich, machine-readable information. I-mail increases the value of mail to sender and recipient, reduces postal system costs, and improves mail security at the lowest additional cost.

Maintain price stability while increasing pricing flexibility. Price stability is critical. Postage rates should not increase faster than the rate of inflation, and improved productivity should enable rate increases to be constrained even further. The Postal Service should offer flexible or negotiated rates that depend on volume, mail mix, and value of service. The Postal Service also should offer dynamic pricing that varies by season, day of week, and time of day. In general we support after the fact review of rate changes for increases below the rate of inflation.

Improve management. The Postal Service should be judged by sound business metrics across all product lines. Performance measures should be based on careful and comprehensive cost accounting of the true operation costs of the service. A Governing Board should be organized around and designed to function in accordance with best practices for financial transparency.

Civil Service Retirement System. The Congress should approve the use of CSRS savings currently held in "escrow." Responsibility for funding the CSRS pension benefits related to military service of Postal Service retirees should be returned to the Treasury.

INTRODUCTION AND BACKGROUND

1. Pitney Bowes

Good morning. I am Mike Critelli, Chairman and CEO of Pitney Bowes Inc. I greatly appreciate the opportunity to testify today. The mailing industry in the U.S. is a $900 billion industry, with 9 million workers, and it drives almost 9 percent of the U.S. GDP. Pitney Bowes is vitally interested in postal reform as a company, as a member of the industry, and as an American taxpayer.

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 44% of the First-Class Mail stream and accounts for more than $25.4 billion in Postal Service revenues or about 37% of total revenue. Pitney Bowes is a major presence in the presort industry through its wholly owned subsidiary, the PSI Group, Inc. PSI, the nation's largest mail presort company, helps high-volume mailers reduce their costs and speed the delivery of their mail. Through the acquisition of DDD Company, which now operates as Pitney Bowes Government Solutions, Inc., Pitney Bowes specializes in screening mail for government agencies with security concerns.

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 are the leading manager of 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.

2. Mailing Industry CEO Council

I also am privileged to chair the Mailing Industry CEO Council. The Council is a non-profit organization whose main objectives are to provide senior executive input on proposed reforms, establish industry standards, and promote the role of mail in industry and commerce.

The Mailing Industry CEO Council was created in 2002 to assist the joint USPS/Industry Mailing Industry Task Force in its efforts to implement its proposed reforms, as well as promote reforms that require the enactment of legislation by Congress. In addition to working to improve public policy with respect to the mailing system, the Council seeks to facilitate the establishment of industry standards that foster industry growth and improve the mailing system.

The sixteen members of the Council represent a cross-section of companies that depend on the postal system for much of their business. Together, we employ nearly 500,000 people, with facilities in every state in the nation generating approximately $50 billion in revenue. Attached to my testimony is a list of the current CEO Council members. I also am pleased to report that Bill Novelli, CEO of AARP, will be joining us shortly. I'm here today to pledge to you that members of the Council stand ready to assist you in any way possible.

MAIL IS CRITICAL TO COMMERCE AND POSTAL REFORM IS ESSENTIAL

Postal reform is essential because the Postal Service is the linchpin of the much larger mailing industry, which in turn plays a key role in our economy. Quite simply, postal reform will help stimulate the economy.

Mail remains a vital piece of the communications flow for individuals and organizations of all sizes around the world, contrary to predictions of a paperless environment. Research and everyday experience confirms that paper messaging will remain a part of American life for decades to come. The challenge is to enable mail to remain a vital communications medium in the 21st Century.

There are over 425 billion pieces of mail generated annually around the world. The U.S. 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 9 on the 2003 Fortune 500, with $68.5 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. It ranges from paper, card and envelope manufacturers, to postal automation equipment providers, direct marketers, printers, publishers, mail processors and package shippers.

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 must 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" – mail that is generated by known mailers. These mailers typically 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.

The postal system, and the economy it supports, stands threatened by many internal and external forces. Mail volume has stagnated due to the state of the economy, electronic alternatives, and concerns about security. Rapidly escalating rates have made mail less affordable, diminishing its value as a communication medium. This needs to be addressed now.

Transformation and reform are required. The U.S. economy cannot accept a continuation of the status quo. Change is required to avoid the continuing spiral of underlying cost escalation, rate increases, and volume erosion.

We agree with the Administration's principles for postal reform. We believe that the Postal Service must be able to implement best practices to reduce costs, set rates and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace. The USPS should conduct its functions transparently and subject to appropriate independent oversight.

WHAT NEEDS TO BE DONE

1. Clarify that *the* mission of the Postal Service is to maintain universal physical mail service.

The Postal Service must focus on its core functions. *The* functions of the Postal Service are accepting, collecting, sorting, transporting and delivering physical mail and packages.

Congress should define the core functions and ensure that the Postal Service sticks to them. This is important since successful businesses today all share a common philosophy – the need to maintain management focus on core products and core competencies in order to deliver superior customer value.

The mission of the Postal Service is universal mail service – universal access and universal delivery at affordable prices. Today, mail touches every household and every business six days a week and provides the communication fabric of our nation. At its heart, the Postal Service offers a ubiquitous "final mile" delivery system.

When Postal Service officials get up in the morning, we think they should be focused on "growing the mail." They should be focused on taking aggressive actions that drive increases in mail volume. They must 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.

We agree with those in Congress, the Administration, and the President's Commission who believe that the Postal Service should remain a public entity, but become leaner and more flexible.

We agree 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 businesses. 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. Postal "privatization" or "liberalization" should only be undertaken cautiously and very gradually.

We agree with the Administration that the Postal Service must be able to implement best practices to reduce costs, set rates and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.

We also agree that there should be a leaner USPS. This can be accomplished by right-sizing the workforce and 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 are significant opportunities for attrition. Forty-seven percent of current career employees are eligible for regular retirement by 2010.

2. Enhance private sector partnerships for the most cost effective postal system.

The American postal system is a nationwide integrated network of mailers, shippers, manufacturers and the U.S. Postal Service. It is the largest single logistics network in this country. The goal should be to reduce the total combined operational, transactional, or other

costs of mail preparation, collection, sortation, and transportation. Only in this way will mail continue to play a vital role in the American economy, including the 20 million small businesses that rely on the mail to market their services, send statements, and collect payments.

The United States has shown global leadership in utilizing the private sector to help the national post fulfill its functions. We agree with the Presidential Commission that these efforts must be continued and expanded. Postal operational efficiency and effectiveness can be optimized by greater reliance on private sector participation. 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-bar-coding and the drop shipping of mail. Worksharing discounts promote economic efficiency by encouraging the 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. Worksharing has allowed the Postal Service to better manage its workforce by eliminating the need to expand its workforce in areas where the private sector can provide the same service.

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.

There are many private sector partnership opportunities. 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.

Postal reform legislation should seek to maximize private sector innovation and collaboration with the Postal Service. The U.S. mailing industry has been very innovative because the U.S. Postal Service has had the kind of relationship with the rest of the mailing industry that has facilitated innovative solutions. Many of the privatization and liberalization approaches tried in other parts of the world have not enabled as much innovation because of the tendency of postal operators to move beyond their core functions into adjacent spaces and to preempt or compete with private sector participants.

Postal reform legislation also should preclude the Postal Service from using its governmental authority, particularly its regulatory authority, to favor itself in competition with private sector businesses. It also should strictly prohibit Postal Service investment in private securities or entities.

Pitney Bowes supports granting the USPS commercial freedoms that will allow it to thrive and prosper in its core functions 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.

3. 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. As the President's Commission recognized, the Postal Service must use technology to increase the value of mail, reduce costs, and improve security.

At the heart of this vision is the Postal Service's "Intelligent Mail" program. I-mail is the use of data-rich, machine-readable information to uniquely mark a mail piece. Mail can be marked to identify the sender, the recipient, the postal product used, the payment received, a piece identification number and value added services. Importantly, the technology is already available to support the next generation of mail in the form of I-mail.

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.

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 mail by ensuring traceability of mail to the sender.

While we applaud the Commission's endorsement of sender-identified mail, we disagree with its 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).

We also need to make postal services more accessible and convenient. The President's Commission discusses "Revolutionizing Retail Access" by moving services away from USPS windows. Its Report says, "alternatives offer an equivalent standard of service ... at substantially less cost." And they do – postage can be provided more conveniently (and at less cost to the Postal Service) through expanded use of meters, PC Postage, ATM's, vending machines, Stamps by Mail, and expanded retail access at drugstores and supermarkets.

The Postal Service's Transformation Plan Progress Report (November 2003) says it is beginning to actively promote less expensive and more convenient alternatives to sales of stamps at windows. It should be encouraged to do so through appropriate pricing incentives because the savings are dramatic. The Postal Service says it costs 24 cents for each dollar in revenue to provide stamps over its retail counters. The comparable USPS cost for mail with meter indicia is 1/10 of one cent.

4. Maintain price stability while increasing pricing flexibility.

The pricing of postal products is extremely important. The Postal Service should price its core mail products to maximize volume, smooth out mail flows, reduce costs, and increase revenue.

The President's Commission agreed with the mailing industry that price stability is a critical element of any postal reform program. This stability requires predictable rate increases for business mailers and predictable individual stamp prices for every consumer. The Commission similarly agreed with the mailing industry that postage rates should not increase faster than the rate of inflation, and that improved productivity should enable rate increases to be constrained even further than the rate of inflation.

We support the President's Commission recommendation that the Postal Service be allowed to offer pricing flexibility subject to an overall constraint based on an appropriate index tied to the rate of inflation. 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 further 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 long as 18 months. In general, we support the Presidential Commission's recommendations for after the fact review of rate changes provided any increases are below a maximum tied to the rate of inflation. We believe that such review will provide the appropriate independent oversight called for the by Administration.

5. Improve management.

We believe that the framework under which postal reform must be accomplished should include financial accuracy and transparency similar to that of publicly traded companies.

The Postal Service and its management should be judged by sound business metrics across all product lines including:

- Profitability;
- Productivity;
- Quality of service;
- Customer satisfaction;
- Customer transactions; and
- Access to services.

These performance measures should be based on careful and comprehensive cost accounting of the true operation costs of the service across all product lines and accurate accounting for benefit cost transfers, charge backs and reserves between the USPS and other government agencies. Costs should be derived through the use of the latest tools, technology and systems available in cost accounting. The Administration has called for financial transparency to "ensure that important factual information on the Postal Service's product costs and performance is accurately measured and made available to the public in a timely manner."

We also endorse recommendations establishing a Governing Board organized around and designed to function in accordance with the best practices for financial transparency. Detailed

organizing principles, scheduling and committee structure will be finalized by the appointed Board to be determined by Congress.

6. Release Civil Service Retirement System escrow funds and correct military service funding.

Earlier this year 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 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.

NOW IS THE TIME FOR POSTAL REFORM

We at Pitney Bowes, and the members of the Mailing Industry CEO Council, believe the time is right to pass significant, meaningful postal reform legislation.

Certainly there is a well-known litany of problems that have developed during the past several years.

- Rates of growth for First-Class Mail and standard mail have been in decline since the 1980's.
- Electronic diversion threatens to accelerate this trend.
- Continued high costs and lack of productivity are causing a deteriorating financial situation.
- GAO put the Postal Service on its "High-Risk List" in 2001.
- The Postal Service increased postage rates three times in just slightly over three years, with a total average increase of about 14 percent.

However, at the same time, there **have** been positive developments.

- Postmaster General Potter and Deputy Postmaster General Nolan have not only faced up to the situation, but have begun to take serious actions.
- They worked with industry through the Mailing Industry Task Force to identify ways to grow mail and cut costs under existing authority – and then went ahead and implemented them!

- In April 2002, in response to Congressional requests, the Postal Service issued its Transformation Plan to chart how it will adapt to the future.
- The Postal Service has reduced its workforce by about 68,000 career positions since 1999, of which about 45,000 occurred in the last two years.
- The Postal Service will deliver $5 billion in cost savings through 2006.
- The Postal Service proceeded with a Negotiated Service Agreement with Capital One and secured approval by the PRC.
- The Postal Service obtained some breathing room as a result of legislation fixing its CSRS overpayment.
- The Postmaster General committed to no new rate increases until fiscal 2006 at the earliest.

Clearly Congress has been hard at work for several years. In the House, Congressman McHugh has led the reform effort for quite a while. More recently, Senator Carper introduced legislation that incorporated and expanded on some of the earlier House proposals. Chairmen Davis and Collins have brought new energy and leadership to the Committees and demonstrated a year ago that they can work in a bipartisan manner as well as with each other in taking quick action to correct the CSRS over funding problem.

Significantly, last year the President's Commission on the U.S. Postal Service did a superb job. Although the commissioners were intentionally not from the mailing industry, they thoroughly examined the issues surrounding postal reform. We believe they developed a blueprint for the future with workable solutions to challenges that face the Postal Service.

They called for dramatic, aggressive measures that will enable a viable USPS in the 21st Century so that the Postal Service can continue providing universal service. Clearly the Commission's recommendations built upon a lot of the earlier intellectual work in the business community, think tanks, and here on the Committees. The Commission also acknowledged that the Postal Service has been moving in the right direction. But the Commission called for moving farther, faster. For this, we need postal reform legislation.

Finally, we are pleased that President Bush's Administration, after receiving the recommendations of the Commission, has called on Congress to enact comprehensive postal reform legislation that "reflects the sensible, balanced approach the commission recommended" in order "to ensure that the United States Postal Service can continue to provide affordable and reliable universal service, while limiting exposure of taxpayers and operating appropriately in the competitive marketplace."

We know what needs to be done.

The time to do it is now.

Thank you.

Mr. MCHUGH. Thank you very much, Mr. Critelli. Again, I deeply appreciate your leadership and involvement on this.

Next, Mr. William Davis, who is president and chief executive officer of R.R. Donnelley, a proud company of Chicago, IL, and more importantly from the perspective of this hearing, an individual and a firm that has been deeply involved in this issue from virtually the first day, at least in so far as my perspective is concerned.

Bill, thanks for being here. Our attention is yours.

Mr. WILLIAM DAVIS. Thank you, Mr. Chairman, and my particular thanks to my Chicago neighbor and soulmate, Danny Davis, for everything and for your kind comments a few minutes ago.

Good afternoon, I am Bill Davis, chairman, president and CEO of R.R. Donnelley. I sit before you today as a founding member of the Mailing Industry CEO Council and as a member of the U.S. Postal Service's Mailing Industry Task Force, and then finally as CEO of the largest commercial printer in the United States and one of the largest users of the U.S. postal system. R.R. Donnelley fundamentally supports the recommendations of the President's Commission and we urge Congress to push ahead right now, right now, with changes that will ensure that we in fact have a healthy, viable and affordable mail channel for the future.

Change is essential to the health of the U.S. mailing industry. I know you have heard the numbers before. I have to repeat them quickly. This is a $900 billion industry. There are 9 million jobs at stake, only a small percentage of them actually in USPS. That is not quite 9 percent of our GDP. That is the reason why I am here today. This is so much more than reforming the U.S. postal system. This is about our economy. This is about our jobs. This is about our future. We need to keep that in perspective throughout our joint efforts on this transformation. The total postal system as it stands today is inefficient. The President's Commission recognized these inefficiencies and now recommends major changes. I hope you will agree with the President's Commission and me, and I have heard this already today, you do agree that there is substantial potential for improvement.

However, any piece of legislation that simply protects the status quo is not going to be acceptable. At its heart, the governance concept of the USPS must change. It must change to allow, encourage and, in fact, demand continuous, ongoing improvement. By doing so, the USPS will function more like a business. With my limited time, I would like to focus on two of these areas. One is worksharing, the other, network optimization.

In today's world where technology is constantly changing to allow for new improvements, companies cannot and should not try to do everything themselves. It is impossible for any company to keep up with all that change. As a result, we have all learned to rely on others and their expertise in emerging capabilities in order to maximize our company's performance. Frankly, the USPS does not do enough of this. It tries to do too much itself. The USPS should focus on its core competency, universal service, the ubiquitous presence of that local mail carrier that is delivering to every one of us 6 days a week.

Universal service has become an integral part of the economic and social fiber of our country. Now, worksharing can better allow

the USPS to focus on this core competency, and at the same time drive down costs substantially. In fact, back in 1999, the GAO did a study and showed that the limited amount of worksharing that had already occurred has saved the USPS an estimated $15 billion to $17 billion. Yet it is as difficult today to enter into a worksharing agreement with the Postal Service as ever before. Let me give you a recent example.

At R.R. Donnelley, we and other printers recently reached an agreement with the USPS on something called co-palletization. It took us 18 months to get this done—18 months. And what did we get? We got a 3-year trial. If I were doing this same deal with any private company in America it would take 6 to 8 weeks. And if it didn't work we would undo it. We should not have to work this hard to persuade our partner to reach a result that benefits everybody: our customers, the Postal Service, us, all users of the system.

The second area I would like to talk about is network optimization. Frankly, it is inconceivable to me that the USPS network is not making adjustments constantly. Facility locations, facility size, transportation routing should be changing all the time to keep up with demand, to eliminate redundancy, to eliminate overcapacity, to achieve productivity gains. All businesses need to adjust to changes in customer traffic, demographics, or other factors, especially service businesses like the USPS.

The USPS must be given the flexibility to make these types of changes on an ongoing basis and frankly, politics should not get in the way. As a businessperson I am constantly faced with these hard decisions, closing some facilities, consolidating others, as well as having to outsource non-core functions. I do not mean outsource to India; I mean outsource to FedEx, non-core functions, so we can best focus on our customers and on what Ann Moore and her counterparts expect from us.

I can tell you that closing a facility is one of the hardest things I ever have to do. It is not fun. But I can also tell you that because we do this when needed, we are a stronger, better company. In the long run, it was the right thing to do. The USPS must be granted that same kind of flexibility to make these tough decisions. Furthermore, they must be allowed to make them. Utilizing worksharing and network optimization makes it possible to achieve the lowest combined cost, and that is at the core of what R.R. Donnelley and our customers expect from the USPS, which as Ann Moore pointed out, is an extremely critical component of the business models that we support.

Finally, a short word on parcels. Any effort that will limit the ability or effectiveness of the letter carrier will negatively impact on the important brand of the USPS. That is why we must find ways to encourage first class mail and to continuously focus on improvements to handle parcels, magazines, catalogs, and the like. If any of these classes of service is eliminated or substantially reduced, the costs to cover the route carrier is simply spread across all other classes. That impacts negatively on those companies' business models.

We have a chance right now, a real opportunity, to make the necessary changes to ensure that the USPS and the mailing industry as a whole remain healthy and viable. Frankly, several more years

of business as usual could bring us to a point of real disrepair. This could be a crisis meeting rather than a planning meeting. Let's not allow that to happen. Let's work together. We are all committed on this side to get meaningful reform and get it now.

I thank you very much, Mr. Chairman.

[The prepared statement of Mr. William Davis follows:]

Written Testimony

of

William L. Davis
Chairman, President and CEO
RR Donnelley

before the
U.S. House of Representatives
Committee on Government Reform

Wednesday, February 11, 2004

EXECUTIVE SUMMARY

RR Donnelley believes in the mission of the U.S. Postal Service and wants to support the changes necessary to ensure its continued health and viability well into the 21st Century. The recommendations as described in our testimony, in order of importance, are as follows:

Maintain Universal Service - The obligation to provide universal service imposed on the USPS, must be maintained for economic and social reasons.

Review of Worksharing – Encourage and incent the USPS to engage in more worksharing to drive productivity like that of major U.S. companies. Ensure that worksharing discounts adequately reflect *all* of the variable costs these activities actually help the USPS avoid.

Review of Upstream Processing Networks – The upstream process is a major contributing factor to many other problems that plague the U.S. postal system. While the entire network should be reviewed, there are savings to be realized in the range of $6-8 billion if just the upstream process was realigned. The USPS must be given the flexibility to make this an ongoing process.

Productivity Gain – Give the USPS the flexibility and the incentive to implement the programs necessary to post productivity gains similar to those in the private sector.

Ratemaking Process Changes – Create rates that are more predictable, make rates more market driven, and eliminate the "politics" of ratemaking.

Financial Modifications – The USPS should establish a mandate for financial transparency that mailers can rely upon to develop their own business plans.

Enhance The Technology Infrastructure - The USPS should outsource their information systems and information technology to quickly achieve parity with their private sector competitors.

Cultural Transformation – In order for organizational changes of this scope and magnitude to be realized, they must be accompanied by a corresponding transformation.

Governance – The role and make up of the Postal Board of Governors should resemble that of the boards of publicly traded companies.

Introduction

The United States Postal Service (USPS) is one of the cornerstones of our democracy because of its mission to "bind our nation together through the [distribution of] personal, educational, literary and business correspondence of the people." This has come to be understood by all stakeholders as the mission of providing Universal Service at affordable rates. This timeless goal is 200 years old. In that time, the distribution landscape has changed exponentially. The country has grown; the information and delivery needs of the people have expanded accordingly. Today, an entire mailing industry has evolved to serve the delivery needs of the people based on the USPS' unique ability to provide this distribution whether it takes the form of letters, documents, packages, magazines or consumer goods.

The mailing industry is a key driver of the economy and brings delivery revenues to the Postal Service and its competitors alike. The fact that the mailing industry is a $900 billion industry employing one in every 15 American workers, is a testament not only to the contributions the industry makes to the U.S. GDP, but to how the people have come to rely on the postal system as a critical path for the flow of hard copy and consumer goods.

Through the services we provide the mailing industry, we are acutely aware of the profound role the USPS plays in the American way of life. We at RR Donnelley believe in the mission of the USPS and want to support the changes necessary to ensure the continued health and viability of the U.S. Postal Service that will enable it to last well into the 21st Century.

What does RR Donnelley need from the USPS? Operationally speaking, RR Donnelley wants to see the same dynamic take hold of the USPS as we see in the private sector – specifically, that over time, quality improves while costs decrease. In the case of the USPS, we would expect this dynamic to take the shape of better service levels at a lower cost.

Improvements in service would take a number of forms – delivery should become faster, with a much more precise delivery window that could make using the USPS as predictable as using some of its private sector competitors. Better service could also be reflected as greater market responsiveness – more quickly and readily addressing new and emerging needs in the market.

Maintain Universal Service - From RR Donnelley's perspective, there is much about the USPS that is good and should not be changed. It is one of the most recognizable and trusted brands in America and it does a very effective job of delivering information and consumer goods to every household in the nation, six days a week. In so doing, it provides a service that the American people have come to rely on and would be at a loss without.

No competitive model comes close to providing the level of comprehensive coverage to every home that the USPS' "last mile" capability provides. Nor can the competition provide the same level of confidence and security in the mail as the USPS with its controlled access to the mailbox.

We at RR Donnelley believe that it is essential that the USPS preserve these unique capabilities which is, in large part, dependent upon the USPS retaining two key success drivers: Economy of Scope and Economy of Scale.

By maintaining all current Postal products and services provided today (i.e., letters, parcels, periodicals, advertising mail, books, etc.), the USPS is able to provide convenience, privacy and security to the consumer that would not otherwise be feasible. In addition, keeping this expanded product scope enables the second success driver found in the universal service obligation of the USPS to provide access for the American public and businesses to this broad variety of mail products at affordable and regulated prices. We must find ways to encourage first class mail and to continuously focus on improvements to handle parcels, magazines, catalogs and the like. If **any** of these products is eliminated or reduced, the cost for the route carrier gets spread across the others, impacting negatively on their business models.

Protecting the USPS' unrivaled "last mile" infrastructure - including its network of local postal delivery units and its complementary letter carrier franchise - is essential to the USPS' ability to continue to serve the American people. Considering its relevance to our industry and our nation's way of life, RR Donnelley wholeheartedly supports continuation of Universal Service and exclusive USPS control over the mailbox, thereby assuring security and privacy of the mail and the delivery of parcels. This is where the USPS' core competency and key contribution to society lies; therefore, this is what must be preserved.

Worksharing – Leading companies drive productivity by relentless focus on their core competencies. For everything else, they partner with companies that have complementary strengths. That's what the USPS needs to do and *worksharing* is the first step toward achieving the productivity demonstrated in the private sector. As it is, the current system does not effectively utilize current capabilities and technologies. Worksharing will solve that problem. It will eliminate redundancies.

Worksharing is not going to happen with the current laws and practices though. The USPS is operating under a set of rules and a business strategy that was established 33 years ago. It's out of date. It takes too long to get changes through the system.

For example, it took RR Donnelley over 18 months to come to a worksharing arrangement with the USPS for a co-palletization project—and in the end all we got was a three-year "trial" run. In the private sector, we make arrangements like that all the time and they only take several weeks establish.

In addition, the disarray of the price signals set forth in the worksharing program make it impossible for mailers and mail services providers to optimize their own mail preparation functions and logistics networks to take full advantage of the worksharing opportunities that the discounts are intended to provide.

Mailers would like to see prices structured in such a way as to equitably reward mailers for absorbing additional work and bypassing inefficient portions of the postal stream; such inefficient operations (e.g. BMCs) can subsequently be eliminated.

While some may claim that worksharing discounts exceed the savings realized by the USPS, proper measurement and forecasting models have never been developed to assess the impact of different worksharing initiatives on demand. Under the current methodology, worksharing discounts reflect only the variable costs that the USPS avoids when work is done in the private sector, bypassing the USPS function. Moreover, due to complexities in the aforementioned cost accounting system, the worksharing discounts do not adequately reflect *all* of the variable costs these activities actually help the USPS avoid. Even those costs that are measured are not always passed through in the discounts, resulting in an irrational rate structure that is not truly tied to costs.

The problem is, there is no incentive for the USPS to do worksharing. We need new governance rules that not only allow worksharing, but also give the USPS incentives to do more worksharing. Change is essential.

Retail and Distribution Network Integration – The USPS should always be monitoring and assessing its distribution infrastructure. It is inconceivable to me that adjustments in the USPS network are not ongoing. Facility locations, size, transportation route, all of that should be changing *constantly* to keep pace with demand, to eliminate redundancy and overcapacity, and to achieve productivity gains. *All* businesses need to adjust to changes in customer traffic, demographics or other factors—especially *service* businesses like the USPS. Closing some facilities and consolidating others, outsourcing non-core functions and rightsizing must be done. That's the kind of flexibility the USPS needs to demonstrate but Congress must give them that kind of flexibility.

Neither upstream processing centers nor the existing retail network should escape examination with respect to performance. The Network Integration Alignment Project (NIA) currently underway within the USPS should be given the high priority status it will need to ensure its success. The NIA is significant because it pursues a charter to create a flexible logistics network that reduces the USPS' and customers' costs, increases operational effectiveness, and improves consistency in service.

According to USPS Senior Vice President of Operations, John Rapp, there are a number of significant challenges to the USPS accomplishing the goals of the NIA, including:

- A fixed infrastructure that inhibits the Postal Service's ability to adapt to a changing business environment;
- A disproportionate increase in transportation costs;
- An ad hoc evolution of the distribution network that resulted in non-standard operational procedures;
- Differing and inconsistent preparation and entry exists between mail classes and subclasses;
- Differing and inconsistent service standards also exist; and
- A lack of an integrated information technology solution.

Many of these challenges could be addressed easily through collapsing the existing distribution network and strategically outsourcing upstream processing capabilities to private sector organizations such as RR Donnelley that have a proven track record for handling these processes more efficiently and effectively, and at a lower cost. This shift could generate savings for the USPS somewhere in the range of $6-8 billion annually.

Upstream Processing – Today's "postal stream" is inefficient and obsolete and its structure is a major contributing factor to many other issues that plague the system, from delivery performance to failure to contain costs. According to the USPS' 2001 Cost and Revenue Analysis, total upstream processing costs in FY 2001 exceeded $19 billion. This expense represents nearly 30% of the Postal Service's revenues for FY 2001. A quick examination of the postal stream can shine some light on the operational "Catch 22" surrounding the USPS' upstream operations.

The upstream postal system consists of three functional layers, each serving an increasingly finer service area than its predecessor. The Bulk Mail Center (BMC) serves the widest geographic area, followed by the Sectional Center Facility (SCF), and then the Destination Delivery Unit (DDU) – or local post office. Current worksharing discounts are set up to encourage mailers to deposit their shipments as far downstream as possible, with the greatest price break being given for mail that is pre-sorted and delivered all the way downstream at the DDU, for "final mile" delivery to the home by a letter carrier. (The letter carrier also serves the mailing public as the "first mile" for correspondence originating from the home.)

For many mailers, DDU insertion provides a very attractive alternative, despite the additional cost that the mailer must incur to sort and transport their product to the "final mile", and the fact that the postage discounts offered do not adequately reflect the cost savings that the mailer is actually providing the USPS. But as mail volumes move downstream, diseconomies of scale occur within the USPS, and the upstream processing centers become increasingly inefficient. Even as the workforce is diminished through attrition, the capital infrastructure and fixed costs remain a burden to the USPS. The USPS has been largely handicapped when it comes to closing facilities.

The Postal network needs to be collapsed and consolidated. Capabilities should be outsourced where appropriate, allowing inefficient upstream operations to be eliminated whenever possible. It is our belief that these changes will have the following efficiency benefits for the USPS:

- An immediate reduction in operating and labor costs of at least $6 billion annually;
- improved service performance through the elimination of touch-points;
- greater throughput and efficiencies through the strategic application of automatic sortation technologies; and
- avoidance of billions of dollars annually of ongoing capital expenditure requirements to support upstream infrastructure and additional stranded investments as first class mail volumes decline in the future.

Productivity Gains

Despite the clear advantages that the USPS' last mile capabilities bring to the American people, there are any number of limitations in its current operating model that do not serve it or its customers well. Despite the significant strides in efficiency that the USPS has made in the last year, it continues to struggle with a number of operational problems, including.

- Failure to achieve productivity increases -- similar to those achieved by private industry -- despite continued capital investments;
- Inability to optimize the upstream distribution network by consolidating and closing obsolete and non-performing facilities and continuing to outsource non-core operations;
- Difficulties in obtaining support for optimizing retail network by experimenting with the number and type of retail facilities providing distribution services;
- Sporadic use of information technology and business data to pinpoint operating inefficiencies and address service issues; and
- Inconsistent operating procedures at Postal facilities because of local management decisions.

A continuous improvement philosophy, penetrating every level of the USPS, is needed to bring about meaningful change – but this critical cultural change is difficult to implement given that the USPS is not incented to maximize profit. This is best seen when you compare productivity gain in the private sector versus the USPS. Since 1970, non-farm businesses have seen a 70% increase in productivity. In that same period, the USPS has seen gains of only 11%.

At the basis of all formal Continuous Improvement strategies, such as the Six Sigma program that has been so successfully implemented at leading companies, including RR Donnelley, there is an underlying "profit motive" that places the need for operational efficiency and customer satisfaction ahead of all others. Without this, the political pull of various factions most impacted by the changes that a Continuous Improvement program entails can derail the focus on operational improvements. A comprehensive Six Sigma program within the USPS would dramatically drive out operating costs, while increasing the reliability and predictability of the mail. We started to implement such programs at RR Donnelley over five years ago. Last year alone, as a result of such initiatives, we drove out costs of nearly $170 million.

Ratemaking – The current ratemaking process is costly, cumbersome, political and outmoded. The process, which was adopted as a last minute thought as part of the 1970 legislation, is based on a classic cost-of-service ratemaking. This type of pricing, which was popular back in the 70s, has since been discarded in all other infrastructures, including the telecommunications, electricity and gas industries. According to documents used to support the PRC decision, as much as 35% of the USPS costs which are "fixed" are allocated to users on a non-cost factor basis, which tend to understate demand considerations.

The changes that RR Donnelley would recommend for the ratemaking process focus on creating rates that are more predictable, streamlining the process to make rates more market driven, and on eliminating the "politics" of ratemaking by establishing an effective checks and balances system that sets solid rate limitations and is structured to protect the interests of users of all classes of mail.

First, the mailing industry needs to be able to plan for the impact of the new rate in their postal budgets. Caps should be set for annual rate increases, tying them to the Consumer Price Index, or some other widely accepted leading economic indicator as well as a productivity factor. If rate increases exceed the limitations established through the business rules set forth in the new ratemaking process, then rate requests will be subject to the review of the Postal Regulatory Commission.

Second, the testimonial review process that both the USPS and the Postal Rate Commission (PRC) conduct prior to the implementation of a new rate case is costly and time consuming. The testimonial records can run into the tens of thousands of pages and result in a published decision that exceeds 575 pages. This type of approach is not capable of producing meaningful results, leaving many key issues to be overlooked.

Third, the ratemaking process must be transparent and properly structured from the beginning in order to prevent outside parties from feeling the need to fight a rate increase. A more transparent process would prevent people from tying up the ratemaking process with the endless cycle of testimonies. Individuals would be able to file their concerns with a Postal Regulatory Commission that will be charged with efficiently reviewing and resolving such conflicts.

For example, since the Rate Commission and the Postal Service disagree on key issues regarding cost variability, there are two versions of the Cost and Revenue Analysis produced each year – one that reflects the USPS' view of cost variability and another, which employs the PRC's view on how to measure and assess cost variability. The two approaches result in vastly different outcomes.

To add further complexity to the ratemaking process, if there is a linkage between the Postal Service's operating plan and its rate case projections, the connection is not made clear. In the final analysis, the USPS keeps two sets of books – one for ratemaking and one for budgeting purposes. One activity-based costing method is required to accurately report costs and provide the basis for sound budgeting and rate making.

Finally, in order for this to work however, the Rate Commission should be given greater authority, including subpoena power, to get at the information they need to effectively regulate the ratemaking process.

Financial Modifications - There are a number of financial changes that the mailing industry would like to see which would ensure that the USPS continues to serve its constituents while remaining financially strong. These are focused primarily on improvements in the ratemaking process, but also include certain regulatory changes that would shift how the USPS currently views revenues, efficiencies and continuous improvement, and establish a mandate for financial transparency, which will hold the USPS accountable to the same standards as their larger private sector counterparts.

Our beliefs about the financial changes required of the USPS are founded primarily on the findings of the General Accounting Office (GAO). In a statement made in February, 2002, U.S. Comptroller, David Walker, stated, "We believe the Service's worsening financial condition intensifies the need for...meaningful reform and transformational legislation."

"The 32-year old USPS business model does not work in the 21st century...and will not work," he continued. In a recent report dated January, 2003, the GAO reports on progress toward the improvements it had suggested to the USPS in earlier reports and those set forth in the USPS' own Transformation Plan, conceding that while much progress had been made in the past 12 months, there is still much cause for concern. It also reviewed the Commercial Government Enterprise (CGE) business model proposed in the Transformation Plan as one that would position the USPS to address the future communications needs of the American people. The CGE model is appealing in that it addresses many of the concerns that the mailing industry has with the USPS in its current form. The continued need for a financial mandate for the USPS to break even should also be examined in the context of its new CGE role. We believe this is an essential component of reform. While it was conceived with the best of intentions, it has failed. It distorts the price signal that results from things such as worksharing incentives by causing the USPS to focus on gross revenue rather than profits. If lifted, the USPS would immediately be able to think and act like a business.

Technology Infrastructure - Better information systems are also critical to the mailing industry for many reasons:

- Electronic filing enables a dramatic reduction of paperwork and eliminates a high percentage of errors;
- Better data enables better performance reporting which is the backbone of any Continuous Improvement initiative;
- Information systems provide greater visibility to the entire Postal stream, enabling the USPS to pinpoint service issues where they start; and
- Greater visibility, in turn, enables the USPS to institutionalize accountability for quantifiable results.

Cultural Transformation – In order for organizational changes of this scope and magnitude to be realized, they must be accompanied by a corresponding cultural transformation. This transformation should focus on three fundamental aspects that currently keep the USPS from becoming a world-class operation:

- An ongoing commitment from Postal employees and management alike to improving efficiency throughout the Postal stream;
- A shift in the USPS culture to become more customer centric and easier to use at all touch-points; and
- An incentive-based organization that rewards productivity and innovation.

Governance
We encourage the Commission to look at the structure, role and make up of the Postal Board of Governors. The Board should be a direct reflection of the size and scale of the USPS and should function just like that of a Board of Directors of a large public corporation. Term lengths and the appointment process should be reviewed. The Board should be composed of individuals, highly qualified to understand the issues confronting USPS, and able to set basic goals and hold management accountable for their realization.

Service Performance Standards - No discussion of opening up the ratemaking process should be undertaken without first taking precautions that rate controls do not come at the expense of declining service performance. In fact, not only should service standards be clearly defined and published, but performance to standards should be publicly reported on as well. Management incentives should be established to ensure that rates are held in check through increased efficiencies.

The USPS should be required to measure and report on delivery performance for all services it performs as a means of ensuring accountability to U.S. citizens, mailers and users of the Postal Service. Further, with the exception of first class mail, the Postal Service does not consistently or regularly evaluate or publicize performance in relation to guidelines and it is extremely resistant to the use of technology (e.g. CONFIRM) that now exists and that would provide accurate measurement of delivery times for other products, such as bulk business mail or time-sensitive mail classes.

Fortunately, there is precedent for public utilities and quasi-utility enterprises publishing service standards and use, and reporting objective measures of compliance. In all cases, the standards are subject to review (or complaint) by an independent regulator and appropriate sanctions can be assessed for persistent failure to meet standards. We are pleased to see this call for public performance reporting reflected in the GAO's January, 2003, report.

Conclusion

As outlined in its Transformation Plan, the USPS recognizes many changes that can be carried out today, without any changes being made to the current statute; still more positive changes, perfectly legal under the 1970 Act, are outlined in the Mailing Industry Task Force report. Congress should empower the USPS to enact these changes; wherever possible, as quickly as possible.

However, there are many issues that the USPS must also address that do require changes in the current law, such as streamlining the ratemaking process and removing the break-even clause. In order to create an environment that is capable of implementing a successful Continuous Improvement program and making meaningful strides in terms of efficiency improvements, it is clear that the USPS must be unshackled from some of the more limiting aspects of the 1970 Postal Reorganization Act.

Two years ago in The President's 10-Year Budget Plan, President Bush set out a clear mandate for government enterprises to "take lessons from the private sector, finding ways to increase efficiency and customer satisfaction...[make] government more accountable and ultimately [raise] citizen's confidence in the ability of Government to work in partnership with the private sector to raise standards of living for every American." We believe that the USPS must fulfill this mandate by leveraging the capabilities and key learnings of the private sector in order to protect Universal Postal Service for American citizens.

Written Testimony of
William L. Davis, Chairman, President and CEO
RR Donnelley
before the U.S. House of Representatives
Committee on Government Reform
Wednesday, February 11, 2004

To accomplish this, Congress must make changes to the 1970 Act that amend the current USPS structure as needed, and to incorporate the best operating practices, incentive systems and technologies used in the private sector that have dramatically changed the face of business over the last 30 years, in order to operate more efficiently and meet the needs of its customers, both large and small.

The USPS should retain its monopoly of letter mail and stay in the parcel business, thus protecting the interests of U.S. citizens. Any new business model for the USPS should allow prices to be more readily flexed to market demand with regulatory limits and rules governing their structure, and a regulatory body at hand to review and settle disputes over rates.

The USPS should also be free to enter into alliances and ventures with related private sector companies that would enable greater system-wide efficiency and outsourcing of non-core operations. In addition to mail processing, the USPS should consider outsourcing their information systems and information technology to more quickly achieve parity with their private sector competitors.

In closing, we would like to commend the USPS on both the Transformation Plan and the progress they have made toward implementing those parts of the Plan that are currently within their power. We are encouraged by the forthright manner in which the USPS and the GAO have identified the issues at hand, and recognize the courage and tough decisions that will be required to build a United States Postal Service best suited for the century ahead.

Finally, we would like to thank the Congress for hearing our testimony, and President Bush for recognizing the need for change in the postal system. We believe that the vision for Government Reform set forth in the 2001 *Blueprint for New Beginnings* provides a solid framework for guiding the Transformation of the United States Postal Service.

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About RR Donnelley

RR Donnelley (**www.rrdonnelley.com**) prepares, produces and delivers integrated communications across multiple channels for content owners, such as publishers, merchandisers, and telecommunications companies as well as capital markets and diversified financial services companies. As a single source supplying services up and down the communications value chain, the company excels in pre-media, digital photography, content management, printing, online services, and print and package logistics. With these integrated services, RR Donnelley helps customers increase the effectiveness of their targeted communications and distribution strategies. Headquartered in Chicago, Ill., RR Donnelley serves a global customer market and has 31,000 employees in more than 200 locations in North America, South America, Europe and the Asia/Pacific Basin.

About RR Donnelley Logistics

RR Donnelley Logistics, a division of Chicago-based RR Donnelley, provides logistics solutions for a wide range of industries, including leading catalogers, e-retailers, publishers, financial services firms and pharmaceutical companies. As a leader in postal logistics, the company annually directs more than 19 billion print and mail pieces and 160 million packages to homes across the nation. Donnelley Logistics delivers predictable, on-time, cost saving business solutions leveraging its nationwide network of sortation facilities, expedited delivery capabilities and advanced technology systems. For more information about RR Donnelley Logistics, contact the company at **www.donnelleylogistics.com**

Mr. MCHUGH. I thank the gentleman. As his testimony underscored his commitment to this, we again express our appreciation for his commitment and leadership.

Last on this panel, as we say, and it is certainly true, not least, Mr. Nigel Morris, who is co-founder and vice chairman of Capital One, one of the true financial powerhouses of this Nation and the planet. We welcome you here, sir, today and we look forward to your comments.

Mr. MORRIS. Good afternoon everybody, and thank you very much Chairman McHugh and members of the Special Panel on Postal Reform and Oversight for giving me the chance to be able to share some of my thoughts here with you today. This is actually the first time that I have had the opportunity to speak at such a forum. Should there be any questions of me later, I hope you will be awfully gentle on me for being such a political neophyte.

I am here actually representing Capital One, a company that I co-founded and am vice-chairman of, but also the Financial Service Roundtable, a group comprised of the hundred largest financial service companies, including but not limited to Citigroup, JPMChase, Bank of America, and also the National Postal Policy Council, a mailing association representing many of the largest mailers and the users of first class mail from a variety of industries including telco, utilities, and other financial service companies.

Capital One is actually a leading provider of diversified financial service products. You may know us from our "What's in your wallet?" campaign. Of course, with vikings and visigoths and yetis and mermaids we are on the TV a lot, but also aside from being the fourth or fifth credit card company in the world, with a vibrant business here in the United States as well as in my home country of England we are also involved in auto loans, installment loans, and mortgages and are building out our portfolio at a rapid rate. We have 17,000 people, 47 million customers, and that gives us a relationship with one in four or one in five American households. We have revenues of $10 billion and growing. Six years ago, we had only 10 million customers. We now have nearly 50 million customers. We acquired every single one of those customers, almost every single one of them, through the mail. So we have to be very indebted to the Postal Service for allowing us not only to talk to those customers basically every month but also for the ability to build a tremendous franchise and now one of the largest credit card issuers in the world. We owe a great deal to the Postal Service for enabling us to do that.

Today, we are the largest first class mailer in the United States and have been for the last 2 years. So the USPS clearly is a vital, incredibly powerful part of our business model, without which I think we would be in very deep trouble. It is in the light of that that I have the opportunity to talk to you today, because I think we today face some really grave threats to the USPS's business model. The USPS's success is critical to our success in being able to deliver product and to be able to service our large and burgeoning and increasingly demanding customer base.

It has been 34 years by my count since we last had significant postal reform. Thirty-five years ago we did not have any cell phones. Thirty-five years ago the Internet was a twinkle in some

techie's eyes. The world has changed immeasurably in that period. Today, the USPS has to deal with a torrent of technological change. Thanks to those changes, consumers can talk to each other, businesses can talk to their consumers in very different ways. The post office clearly has an opportunity to do a better job of keeping pace with those technological changes.

Left unaddressed, the Postal Service's financial instability will ultimately lead to a vicious downward cycle. The cycle goes like this. Higher postal rates drive away customers and revenue. Fewer customers means lower volume and lower revenue because people, if prices go up, people mail less. Lower mail volume will force the post office again to raise its rates. Lower volume and lower revenue will create pressure not to invest in people and technology. The end result is a perpetuation of the downward cycle where we are charging more and more to fewer and fewer. It is a death spiral, but I do not think it has to be that way.

Clearly, mailers have other options. We can communicate with our customers via the Internet. We can do it on cell phones. But the mail is a critical part of many of our business models, and we very much want it to be and continue to be a vital part of that model. The effective mail system is just as important as a sound highway system. I think that is how we need to think about it.

That is why I am here today. I do not think we can afford to wait on this. The opportunities the post office has are just tremendous, but it takes bold and it takes unprecedented steps. I do not think we are talking here about tinkering at the margin with a business model that needs some tweaking. I think we are talking about something much more audacious, much more fundamental, and in that, much more difficult. I believe the Postal Service has to tap into the talents of the people it has, develop them, and grow their skill base so they can face an increasingly complicated world. It needs to harness the technology it has and invest in more technology. It is not just technology for reducing costs though, that is an important part of it. It is technology in delivery. It is technology in service levels. It needs to make the cost structure more productive and more flexible so it can deal with changes in revenues. It needs to develop innovative, value-added products and services. The Postal Service has some very unique assets. It has the monopoly on the last mile delivery. It has a tremendous brand. Those things can be levered, as well as many other things. Such innovations include the negotiated service agreements, which really provide incentives for mailers such as Capital One to actually mail more. I think we are in the very beginning of a major opportunity. The business basically has to become much more nimble, much more pragmatic, and be able to meet the changing demands of customers, particularly in a world where technology is moving at such a tremendous rate.

We have had the challenge to work with the Postal Service in the development of one of those innovations. That innovation is the negotiated service agreement. Basically, the idea is that we as Capital One agree to receive undeliverable first class mail back to the company electronically rather than physically. It is much cheaper for the Postal Service, something like $40 million over the next 3 years, a significant savings. In addition to that, we receive volume

discounts on first class mail. So if we mail more than we were going to mail, we basically at the margin get a lower price. That incentivizes us to mail more, which means that the post office is able to put more volume through its fixed-cost structure, which means it creates more sustainability in the business model.

I think that is a wonderful story, and I am hats off to the people at the Postal Service and at Capital One who worked tirelessly to put this together. The challenge is that we filed for that more than 18 months ago. It took nearly 2 years to negotiate that deal. As we are aware today, nobody else is waiting in the wings to put together any such kind of NSA. I do not think that is anybody's fault. I think it is the fact that it is very difficult to do. It is a very onerous process, but the opportunity is clearly there for the Postal Service to incent companies to reduce their costs and in doing so put something else on the table for the company, and I think there is a real opportunity to build it.

NSAs and arrangements like NSAs help everybody. They help the Postal Service by creating an increase in revenue stream. They help the companies of America and they help the U.S. taxpayer. They also help the customers and the people out there who receive the mail every day. Mr. Chairman and members of the committee, I strongly feel that implementing reforms like the NSAs and other things are really critical to the future. I also think it is worthwhile and important to recognize that reforming the post office is not an overnight project. We are not talking here about clicking our fingers and immediately moving to a different level of business capability.

To achieve the kind of changes that we are talking about will require enormous patience from people on the dais. It will require a lot of investment and it will take a long time to do it. The Postal Service is very large, very complicated, and it requires an enormous amount of change. To do that, we need to align the staff and the investment dollars against specific goals, agree on those goals, set milestones, measure them, monitor them, report them, have a progress mechanism that makes sense, and establish clear accountabilities and transparencies.

I believe that this all can be done. I believe it can be done because I have seen the changes in the Postal Service over the last couple of years. Many Americans should take encouragement from the outstanding successes and the solid efforts that have been made in the last few years by Jack Potter, his management team, and the 800,000 dedicated postal workers out there. It lowered costs by $1.1 billion last year, achieved 4 consecutive years of positive productivity gains, implemented a new pay-for-performance system for supervisors, postmasters, managers, and executives. These are big changes, but it is a drop in the ocean. In light of these accomplishments, we believe that the reforms that I have outlined today are not only realistic and achievable but also possible and incredibly exciting.

Finally, I would like to put my word in here on the CSRS and urge speedy action to eliminate the escrow provision of the Postal Civil Service Retirement System Funding Reform Act. I urge you to remove the escrow created by legislation, which will allow the Postal Service to put these assets to better use and prevent a larg-

er rate hike for all users in 2006. I urge you to transfer the cost of the military-related CSRS benefits from the Postal Service to the Department of the Treasury, as recommended by the Presidential Commission on Postal Reform. These steps will allow the USPS to have the financial breathing room to tackle some of the reforms and some of the actions that I have highlighted.

So in conclusion, Mr. Chairman and members of the special panel, thank you very much for listening to me, and thanks for the opportunity to be able to speak.

[The prepared statement of Mr. Morris follows:]

TESTIMONY of NIGEL MORRIS
CO-FOUNDER and VICE-CHAIRMAN
CAPITAL ONE

Answering the Administrations Call for Postal Reform

BEFORE the
House Committee on Government Reform
Special Panel on Postal Reform and Oversight

February 11, 2004

INTRODUCTION

Chairman McHugh and Members of the Special Panel on Postal Reform and Oversight, thank you for the opportunity to share Capital One's views on the growing need for effective reform of the United States Postal Service ("Postal Service"). The financial services industry is one of the Postal Service's most important customers and ensuring a healthy future for the Postal Service is of great importance to Capital One and others in our industry. We appreciate the commitment made by you and Ranking Member Davis, along with the Chairman Tom Davis and Ranking Member Henry Waxman of the Committee on Government Reform, to making postal reform a top priority for the second session of the 108th Congress.

Capital One® Financial Corporation is a publicly held holding company based in McLean, Virginia. A Fortune 200 company, Capital One has over 47 million accounts, $70 Billion in managed loans and 17,000 associates. As one of the world's largest issuers of Visa and MasterCard, Capital One is best known for its low rate credit cards, however the company also offers a variety of lending and deposit products including auto loans, installment loans, CD's, money market and IRA's. Integral to the success of our business model is the United States Postal Service. The mail channel is our primary distribution channel for communicating with current customers and making offers to potential customers. In 2002, Capital One ranked as the largest producer of First-Class mail in the United States. Our postage spend was in excess of ½ billion dollars, accounting for over 1% of all mail volume of the USPS. By all measures this is our largest supplier relationship.

Our views today are strongly shared by the Financial Services Roundtable, an organization representing 100 of the nation's largest integrated financial services companies which provide banking, insurance, securities, and investment products and services to American 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. In light of the increasing financial instability at 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.

Our views are also shared by the National Postal Policy Council, of which Capital One is a member. Representing many of the nation's largest business

users of First Class mail, NPPC has members in the banking and financial services, utilities and telecommunications, insurance and other industries. Collectively, NPPC members account for an estimated 40 billion pieces of First Class mail annually, which is more than 40% of 2004's projected 97.9 billion pieces.

Jobs and mail go together. The mailing industry contribution to the economy amounts to about $900 billion in economic value or about 8 percent of GDP. Of the 137.6 million people employed in America today, nine million jobs are directly connected to the mailing industry. That represents six percent of all jobs. The mailing industry is an important primary and secondary employer and a vibrant and healthy Postal Service is critical to the U.S. economy, the financial services industry, and to the future of Capital One.

We are very pleased that President Bush has formally urged Congress to act quickly on postal reform this year. We agree strongly with the five overarching principles of postal reform laid out by President Bush in December 2003, including the principles of best practices, transparency, flexibility, accountability, and self-financing. We would also like to recognize the hard work of Chairman McHugh for championing the Postal Reform effort in Congress. In 2002 Chairman McHugh introduced a bill (HR 4970) that encompasses the principles outlined by the Administration. I understand this bill will form the basis for legislation he intends to introduce soon and wholeheartedly support the concepts he has embraced in his legislation.

The principles outlined in the recent call for action from the White House echo the recommendations of the findings of the President's Commission on Postal Reform. Our company and the financial services industry have also carefully assessed the July 2003 report issued by the President's Commission 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.

We expressly 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. Abolishment of the escrow provision of the Postal Civil Service Retirement System Funding Reform Act (Public Law 108-18) will improve the Postal Service's revenue and rate planning. This is a top priority for Capital One and the Financial Services Roundtable and we urge the Committee to take swift action to correct this problem. The substantial rate increases that will result if action is not taken

would have significant financial impact to the mailing community, the financial services industry, and the nation's overall economy.

Fortunately, Congress now has the opportunity to prevent large rate increases by addressing the CSRS issue, together with comprehensive postal reform. Capital One and the Financial Services Roundtable believe that the pieces are in place for the Postal Service to be reformed into an organization that operates like a business focused on providing quality and affordable services and working with its customers to develop new and innovative products. We appreciate your leadership in promoting the meaningful systemic changes that will enable the Postal Service to better serve its customers, control costs and maximize efficiencies for the long term. These reforms will, in the long-run, protect jobs and allow U.S. businesses to flourish.

THE POSTAL SERVICE IS IMPORTANT TO CAPITAL ONE AND THE FINANCIAL SERVICES INDUSTRY

A healthy future for the Postal Service is essential to Capital One and to the financial services industry. A study conducted on behalf of the Financial Services Roundtable found the financial services industry generates and receives as much as 25% of all mail handled by the Postal Service. Considering mail both sent and received, the financial services industry is one of the Postal Service's most valuable customers. We recognize that businesses need stable postal rates in order to facilitate a multitude of investments that will grow the economy. With the right conditions, the private sector will continue to grow, invest, and create jobs.

The financial services industry has grown substantially since the 1980s when a series of moves to deregulate the industry began. In large part, this growth has occurred because deregulation has permitted new products and services to be offered and new entrants to participate in the industry.

The Postal Service also played a key factor in our growth. The USPS provides a convenient, relatively cost effective, tool to communicate with new and existing customers (billing statements and other important account information) and consumers about new products and services. For new entrants, like Capital One, the mail channel has been critical.

As a result, financial services markets have become more innovative and competitive and American businesses and consumers have benefited from improved, lower-cost, and friendlier financial arrangements.

PriceWaterhouseCoopers projects that the financial services market will grow 81% between 2001 and 2010 – from less than $3 trillion to almost $5 trillion.[1] This no doubt reflects the stimulus for growth and innovation -- through competition -- that comes through the use of individualized offers in the mail.

NEGOTIATED SERVICE AGREEMENTS (NSA)

Because mailing is such an integral piece of Capital One's business, we were very pleased to be the first company to sign a Negotiated Service Agreement with the Postal Service in June 2003.

The Negotiated Service Agreement (NSA) is a pricing strategy that gives the USPS the ability to customize its service offerings and rates to address customers' unique mailing needs and encourages cost-efficient behavior. This is standard practice in the business community. Under current law, NSAs are one of the few ways the Postal Service can pursue pricing flexibility, which is a critical element of postal legislative reform.

This first NSA features cost savings for the Postal Service by returning undeliverable mail to Capital One electronically instead of physically. This alone is estimated to save the Postal Service $40 million over the term of the agreement. Capital One has also agreed to address quality standards well above those required by postal regulations. In return, Capital One receives discounts on First-Class Mail volume above an annual threshold of 1.225 billion pieces.

Providing price incentives for mailers to encourage more mail volume and best practices will help make it possible for the Postal Service to keep rates affordable for everyone. The volume incentives in the NSA help foster increased use of First-Class Mail by Capital One, which helps pay for overhead costs that support the entire mail system. Pricing innovations like NSAs will drive more volume and revenue helping the Postal Service preserve universal mail service which is fundamental to the American way of life.

[1] PriceWaterhouseCoopers (2001)

IMPROVEMENTS NEEDED TO MAKE POSTAL REFORM MEANINGFUL

THE POSTAL SERVICE'S BUSINESS MODEL HAS NOT KEPT PACE

I would like to thank Jack Potter for his hard work. Since taking over the reigns of the Postal Service, he has made great strides, working with all stakeholders trying to improve the Postal Service's financial footing. In 2003 he reduced costs by $1.1 Billion and for the fourth consecutive year has shown positive productivity gains. Equally as important he has designed and implemented a pay for performance program for every supervisor, postmaster, manager and executive of the Postal Service.

While the Postal Service has served the mailing industry well in the past, its current business model is an impediment to its financial stability. Created by the 1970 Postal Reorganization Act the USPS has seen tremendous innovation in the business world and marketplace. Unfortunately the USPS has lacked the flexibility to change with today's fast-paced economy, hindering its ability to meet the changing needs of its customers. The Postal Service needs to engage in a more modern, flexible, and responsive business model. The new business model selected must serve the needs of taxpayers, employees, competitors and most importantly customers.

Taxpayers currently hold all liabilities associated with the Postal Service, so it is in their interest that the business model offers the greatest chance that the liabilities are paid by customers of the Postal Service. Employees need a business model that gives them the best chance for success in the future. Customers need a business model that encourages competition, efficient management and innovation.

Capital One and the Financial Services Roundtable would like to express our strong appreciation for the work being done by this panel. Postal Reform is a complex issue and your commitment is greatly appreciated. The Administration has been a strong supporter, appointing a Presidential Commission to study the Postal Service and recently announcing its support for legislation based on its five postal principles. However, the champion of postal reform that deserves special recognition is Chairman John McHugh. You have continued to press for postal reform for years and we thank you. More importantly you have devoted the time to craft thoughtful legislation in the past. You should be proud of the fact that the legislation you crafted nearly 2 years ago has all the same principles identified by the Presidential Commission and encompasses the five postal principles of the Administration.

Mr. Chairman thank you and we support your efforts to craft legislation that will bring the Postal Service into the 21st Century.

IMMEDIATE REFORMS NEEDED

In addition to the long-term systemic changes that need to be made to the Postal Service's business model, Capital One and the Financial Services Roundtable strongly support some immediate reforms. We urge Congress to take swift action to eliminate the escrow provision of the Postal Civil Service Retirement System Funding Reform Act providing the Postal Service greater financial flexibility to implement the needed reforms required to create a financially stable Postal Service. We also believe the Postal Service should be relieved of any obligation to pay retirement benefits of postal employees earned through military service.

ABOLISH THE ESCROW PROVISION OF PUBLIC LAW 108-18 AND ALLOW THE POSTAL SERVICE TO SPEND SAVINGS ACCRUED FROM CHANGES TO ITS CIVIL SERVICE RETIREMENT SYSTEM OBLIGATIONS

The Postal Civil Service Retirement System Funding Reform Act 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. Studies show that a penny increase in postal rates will cause a one-half of one percent volume decline in mail at the Postal Service. A five percent increase in rates would generate a 1.175 billion unit loss in mail volume or $270 million loss in revenues. Experts have estimated that if the CSRS provision is not fixed, it would mean a 12 percent increase in rates just to pay for CSRS and normal operating costs. Fixed costs could not be covered and we could be looking at another deficit of $2 billion by 2006. We strongly encourage Congress to address and resolve all aspects of the Postal Service Civil Service Retirement System.

RELIEVE THE POSTAL SERVICE OF THE OBLIGATION TO PAY RETIREMENT BENEFITS OF POSTAL EMPLOYEES EARNED THROUGH MILITARY SERVICE

We also believe that Congress should 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. As the majority of these costs relate to military service performed before the creation of the Postal Service and because this decision is inconsistent with every other federal agency, we agree with the Presidential Commission's call to promptly return responsibility for this portion of retiree benefits to the Department of the Treasury.

THE POSTAL SERVICE MUST IDENTIFY INNOVATIVE OPPORTUNITIES TO INCREASE VOLUME AND REVENUE

The Postal Service needs greater flexibility to partner with business to increase volume and revenue. Capital One's NSA is a prime example of the type of solutions that can be developed providing a benefit for everyone involved, the Postal Service, mailer and mailing industry. By creating innovative products and services and being allowed the flexibility to efficiently implement these products and services, the Postal Service can increase the value of their business and grow revenue. This is a win-win for the Postal Service and its customers.

THE POSTAL SERVICE MUST RATIONALIZE ITS NETWORK

The Postal Service should be encouraged to right size their network and eliminate redundancy and excess capacity. As stated in the commission's report, "With mail volumes stagnant, with opportunities to outsource and provide better service at less cost, and with less fixed infrastructure to maintain, the Postal Service has significant opportunities to rein in the costs of its logistics network."

THE POSTAL SERVICE MUST KEEP PACE WITH TECHNOLOGY

In order to continue to support economic growth and ensure the American pillar of universal postal service, the Postal Service must take ownership of the technological advances that are needed to ensure the vitality of the Postal Service. Communications through faxing, harnessing of computer technology, online bill payments, and emailing are all daily challenges to the Postal Service. The Postal Service faces significant constraints to the effective use of technology because of its (1) non-standard operating plans and processes; (2) weak basic information infrastructure; and (3) limited investment capital. These constraints and challenges will only be effectively addressed through a more nimble and business oriented approach focused on the effective use of available resources to maximize the benefits to the Postal Service.

CONCLUSION

In conclusion, Mr. Chairman, Capital One and the Financial Services Roundtable would like to thank you, Ranking Member Davis, as well as Chairman Davis and Ranking Member Waxman for making postal reform a top priority for 2004. In light of President Bush's recent call for action, the time has never been better for achieving meaningful reform. We fully support your approach to postal reform which adheres to the guiding principles set out by the President, and we strongly urge Congress to take quick action to abolish the CSRS escrow provision. We also support legislation that would relieve the Postal Service of the obligation to fund the military service component of its CSRS retirees' pension, give Postal Service management more flexibility in negotiating NSAs, and allow the existing rate structure to be replaced by an incentive-based structure.

The size and complexities of the Postal Service dictate that true reform will require a long-term view and patience. It is worth noting that it could provide a model or set a standard for improving other government functions providing for improved government services at lower costs for taxpayers. However, action is needed now to begin the process. As postal reform progresses, Capital One, the members of the Financial Services Roundtable and the members of the National Postal Policy Council look forward to continuing to work with the Committee to swiftly enact the reforms needed to sustain a viable Postal Service that can maintain affordable rates and efficient services.

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Mr. MCHUGH. I thank the gentleman for being here, and thank him for his enlightening testimony, at a truly historic moment, congressionally speaking: your first appearance, as you noted, representing a company of very significant fiscal impact in both the Nation and the world. I guess you could describe it as a "What's in your wallet?" company meeting a "What's in your wallet?" Congress. [Laughter.]

So if I could ask one question of each of the panelists. If you could list one or two, three at the outside, "must-haves" in terms of any piece of reform legislation, what one or two would you pick?

Mr. Smith.

Mr. SMITH. I think, Mr. Chairman, the one thing that is important to get the legislation through and solve a lot of people's fears about this is to have an appropriate firewall or appropriate control mechanism on the competitive product so the funds generated by the monopoly portion of the business don't go in and distort a competitive market. I think the reason that people are so concerned about that is what has gone on in Europe. As I am sure you know, or most of the committee knows, the British, the French, the Germans, and the Dutch all made the decision that they were going to permit their postal monopolies to take the funds from the mailers and the customers of that postal monopoly and to diversify into competitive markets.

If you look at it from a purely return on investment standpoint, it is absolutely crazy. There is no rationale for it at all. You have taken 20 percent margin monopoly business cash-flows that really belong to those mailers or to the taxpayers of those countries and allowed managements to diversify sometimes in businesses that have a 1-percent margin that then has to compete against private industries on an unfavorable, unfair basis. So I think that is a key element of this and it is essential to have an appropriate mechanism if you are going to get the support necessary to pass the bill.

Mr. MCHUGH. Thank you, sir.

Ms. Moore.

Ms. MOORE. We would like to see the escrow provision released and CSRS addressed. I think the only thing in the Presidential Commission which was just excellent was that we would like the idea of a CPI cap passed by Congress, rather than left up to a regulatory board. Then finally, we really do need service standards so that we have timely news magazines. We have to ensure that what we pay for really meets minimum service standards for all classes of mail.

Mr. MCHUGH. Thank you very much.

Mr. Critelli.

Mr. CRITELLI. I am going to mention two things. One is on the broad theme of growing the mail, I think there needs to be a commitment to growing the mail and I believe pricing flexibility to enable the Postal Service and the industry to grow and mailers to grow is very important. I also think that, consistent with the notion of partnerships, there really needs to be encouragement of more work with the private sector to produce the lowest-cost product at the best quality standards.

Mr. MCHUGH. Thank you, sir.

Mr. Davis.

Mr. WILLIAM DAVIS. Yes, I will start off by echoing what you just heard. Smart partnerships in work-sharing areas are critical and they offer tremendous potential that is yet unrealized.

Second, I believe that a comment I made earlier about optimizing the network on an ongoing basis. We have too many places in the wrong place. We need some places in other places. We have to get at that and provide the right kind of service, the kind of service that Ann and her counterparts demand, by optimizing our network.

Finally, no business can be sustainable without growth.

Mr. MCHUGH. Thank you, sir.

Mr. Morris.

Mr. MORRIS. Chairman McHugh, I think the post office is under siege today, and I think the forces that are upon it are likely to worsen than get more benign. As a result of that, I fear that any kind of one-off or piecemeal activity will not lead to the kind of long-term sustainable outcome we need. So I say to you that I think the Postal Service needs to become a business, and much more businesslike, in that it needs to have pricing flexibility and it needs to be able to build volume, and not just volume that is in the traditional first class area. It needs to focus in a mammoth way on quality and service delivery. It needs to build a capability around innovative and new products to different segments. That is a key part of building volume. It needs to focus on productivity, best practices, and looking to variablize its fixed cost structure. And last, it can only do that if it invests in people and technology.

To me, the one thing that hits me like a hammer is the need to run the Postal Service like a business. I will add, at the end, I think that really focusing on the CSRS is necessary to provide the breathing room to enable this to occur.

Mr. MCHUGH. Thank you, sir. Thank you all.

Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much, Mr. Chairman. I certainly appreciate the testimony from each of you.

I notice that the President's Commission recommended that the Postal Service should meet the highest standards of corporate leadership, including a strong board of directors guided by the best business practices. We have talked about that a bit in terms of how do we move the Postal Service toward becoming, as some have described, a business. What are those best business practices that they may be talking about? Could we just each comment on that?

Mr. SMITH. Well, I think it starts with the corporate governance structure as you just mentioned, how the board is going to be appointed and what the criteria are for their selection. But I think equally important is to give the Postal Service management the potential to run their operations like we all run our operations. You have to have incentives for managers or rank and file employees, for that matter, to produce certain results against business objectives, to improve productivity, and to develop new products and services.

I think the Postal Service management has to be given the flexibility to configure their network to meet the demands of the marketplace, rather than to meet some arbitrary criteria that is not market-driven. All of the things that have been mentioned here about partnerships and incentives and so forth to be more innova-

tive have to be inherent in the delegated authorities to the management of the Postal Service.

I think it is just those two things, and then of course you have the third, an unusual aspect, which is the mandated universal service from Congress, with the regulator having the power to set those rates or whatever the case may be. I think it is just that simple and that straightforward. I do not think that it is impossible to do that at all.

Mr. CRITELLI. If I may comment, financial transparency is one of the key governance practices that the Postal Service, like all other organizations, needs to follow. I would just mention a couple of items. One, I referred to mail with intelligence or intelligent mail. One of the advantages of the work that has been done by the Mailing Industry Task Force, and this particular work has been chaired by Charlie Bravo of the Postal Service, is to get better visibility and auditability of day-to-day postal operations, first to track the mail and track activities so we can get better costing.

Second, and I think CSRS legislation can go to help correct this, what is the real cost of running the postal business? It is very difficult to do that when you have costs imposed from outside the Postal Service that really do not relate to the real day-to-day cost of operating the business. So I think financial transparency is a theme that would be consistent with good governance today.

Mr. DAVIS OF ILLINOIS. I think the penultimate answer could be a broader board of directors, make it more difficult or hamper best practices, meaning that the broader group of directors are us, the Congress and the general public in a real sense.

Mr. WILLIAM DAVIS. I would comment on that. Realistically, the answer is yes. I know who my boss is and it is 10 other directors and they are all independent outside directors. I think the thing that makes it work for us is that it is a very diversified group of people. I mean diversified by experience, the things they bring to the table that enhance my performance and capabilities. I do not see that in the postal process to the same degree. It is not as intimate in the postal process because of the scale and scope that you are describing. So I would say that is a problem. But I do believe that if you did increase the actual financial transparency, if we could look at a document every quarter for the Postal Service like we do for all of our companies, it would allow that board to be much more crisp in their dealings with management because they would be measured as a board on the performance of that company and the plans of that company, just like ours are.

Mr. DAVIS OF VIRGINIA. Thank you very much.

Mr. MCHUGH. I thank the gentleman.

The gentlelady from Michigan?

Ms. MILLER. Thank you, Mr. Chairman.

I think this question is to Mr. Critelli from Pitney Bowes. My family was in the marina business and I remember 35 years ago when we got our first Pitney Bowes meter and I just thought that was the coolest thing ever. That was my job to go down to the post office once a week and get that meter filled up and give the postmaster a check and you get your little red ink and fill all that up. Now it seems so unbelievably antiquated, but it was great at the time. You talk about 35 years and what has changed. Could you

expand a little bit on what kind of technology is happening in your industry and how it is positively impacting? It has the potential to positively impact the postal services. You have talked about intelligent mail. Who has to do what to make I-mail a reality?

Mr. CRITELLI. OK, first of all, I think the best benefit that we have provided in the last 25 years, and we really started in 1979 when we launched postage-by-phone, was making postal services and postage purchases available 24/7. We talk a lot about retail access, but supplementing what needs to be done at a post office, which is something like mailing of packages, with giving the people the ability, both businesses and small home offices and consumers, access to postal services 24/7 is a major benefit. Today, that is available.

Second, in conjunction with this whole move toward tracking and tracing of mail, being able to put variable data on every piece of mail. The example I always use is the business that today can track mail and know whether customers have paid their bills or whether a marketing piece has hit, so that they can coordinate other parts of a campaign. All of that is possible today.

The Postal Service has invested heavily in,under the great work of Postmaster General Potter and his engineering and technology team, cameras that capture data and integrated data servers. They have done a great job in presenting that data through the "Confirm" product to the mailing public so that people can actually track their mail pretty closely from origin to destination. That gives it a high degree of value. It is something that Fred Smith did years and years before the Postal Service and he really showed the way in the package delivery industry. Now it is possible to do that in the letter mail arena.

As I said, in the fight against terror, being able to narrow the scope of the mail where we have to do the more sophisticated security screening would be of great help to the Postal Service and the public. All of us, even in the midst of the anthrax crisis, in the industry were doing surveys and they showed that people trusted the mail that they got from an American Express or from another known mailer. They had difficulty trusting mail where they either did not recognize the return address or where there was no return address. Putting marks on mail helped narrow the scope of that anonymous mail and makes it easier to provide mail security.

I could go on a lot longer, but I will just focus on those three benefits.

Ms. MILLER. Thank you. One more question to you as well, sir. You mentioned dynamic pricing.

Mr. CRITELLI. Yes.

Ms. MILLER. And having the flexibility given to the Postal Service to be able to change pricing at a very quick rate, I suppose. Many of you have testified about how important it is as you are doing your business modeling to have a cap, to have predictability. I am just trying to understand what you are saying. If we were to give the Postal Service the ability to change prices very quickly, wouldn't that negatively impact the private sector's ability to do their modeling?

Mr. CRITELLI. I think the private sector was talking about price increases. I think if you went to private sector companies and said,

"If you can get the mail in in August when it is a little lighter volume, we will reduce your rates," I think that would be very favorably received.

I would say this would be equally true of consumers, as well as businesses. I know the greeting card industry has talked about a different rate for getting the greeting cards in before mid-December. So the idea of giving the Postal Service seasonality, as I said, there is a lot of creativity in these other industries. The phone companies have adopted these weekend pricing plans and hotels have off-peak pricing. Why shouldn't the Postal Service have the same ability to do promotional pricing to increase the volume of mail and increase the number of jobs in the Postal Service and in the industry.

Ms. MILLER. Thank you. Just one final question. Mr. Davis spoke about some of the worksharing agreements and you gave us a specific example of an agreement that you have. It took you 18 months, I think you said, to get a 3-year pilot program. Could you tell us, perhaps give us some specifics on why it was so hard for you to do so, and specifically what we need to perhaps include in a piece of legislation to allow flexibility for the Postal Service to not let that happen?

Mr. WILLIAM DAVIS. Thank you for that question. In fact, in order for us to do this, we had to go through a tremendous amount of documentation to demonstrate the expected benefits and costs and impact across a whole cycle of factors. It had to then be reviewed extensively by the Board of Governors and Rate Commission and so on and so forth. It is ironic because the net result of this, the Postal Service hates sacked mail. They love it if you can bulk stack it and have it bar-coded so that they can easily handle it when it comes into a bulk mailing center. What this does is take a bunch of magazines that are now packaged individually because they are individual titles, into sacks based upon final zip code sorting. It allows us to take an inter-mix, different titles of magazines, which of course is to the benefit of the mailer if they get a discount for this, on a skid, all bulk mail for certain delivery locations, take it right to the bulk mail center, and let them just move it right offline into wherever they want. What has happened so far, we have been at this for now about 6 months, we are reducing the number of mail sacks by over 90 percent, over 90 percent in the test, and it is just a test. I cannot tell you the immense amount of money that we will save.

The other thing we are doing, if you want to talk about helping the economy, is the small magazine companies now get to look like Time Inc. We can consolidate the mailings from 10 or 12 small regional publishers, mail them bulk collectively together where they go to the same address, and they can get the same treatment, handling and benefit in the postal system, and therefore cost production, as a large mailer.

It is very frustrating that it is so hard to make something happen that makes so much sense throughout the system.

Ms. MILLER. Thank you very much. We will certainly take that into consideration as we do our legislation. Thank you.

Mr. MCHUGH. I thank the gentlelady.

Mrs. Maloney.

Mrs. MALONEY. Thank you very much. We certainly appreciate all of your testimony. All of you testified in support of postal reform. What would happen to your business if you did not get it, say, in the next year? What would be the impact on your business, if any?

Mr. WILLIAM DAVIS. I would say that for our customers who are large and small catalogers, large and small business mailers like Capital One, and large and small magazine companies, it would be another significant rate increase and it would substantially decrease their efforts to use the U.S. mail as part of their business model, and that is a fact.

I have been in this printing industry for 7 years. I have watched the mix between our customers' costs, we break it down, the paper costs, the printing and buying costs, and the mailing costs. It used to be a third, a third, a third. Right now, just in 7 years, I have watched it go to 50 percent postage and 50 percent print, paper and bind. So instead of 33 percent it is now 50 percent for postage. That is because in this tough economy and with all the improvements we have been forced to make in the paper industry and in the printing industry to meet their needs, we have reduced our prices while the Postal Service has had, I guess in that period of time, four increases.

Mrs. MALONEY. Since you mentioned Mr. Nigel Morris' business and Ms. Ann Moore's business, would you like to comment for yourselves?

Mr. MORRIS. I would be really happy to. Thanks very much.

We are in the business of measuring the cost to acquire a new customer. That is where the bulk of our first class mailing is deployed. In the event the prices go up, a calculus of a Capital One or any other major credit card issuer or mailer will say, "Now, is this a piece of mail that we still need to spend money on?" And if we do still need to go after the same customer, is this the best way to go after that customer?

It is very clear that you can book credit card customers through three principal channels: over the mail, we talked about that; the Internet, e-mail; and via the telephone. We have seen the cost of telephone booking fall significantly as the cost of telephone time has fallen dramatically over the last few years. The cost of an e-mail, depending on how you measure it, is awfully close to nothing. An increase in the cost of sending out a piece of mail, no matter how well-targeted, if that goes up, the calculus would be to say, "Now, we need to shift some of our business away from mail volume."

I think this is really an important thing to consider as we wrestle with how quickly to try to tackle these reforms. Businesses are in the business to make profit. Their shareholders demand that of them. We are in the business of booking customers for the lowest possible price. If the price of one channel goes up, we will deploy more volume to other channels. That will mean that a price increase will in the end mean less volume. I think the impacts of that type of decisioning on the system that we have articulated is pretty catastrophic.

Ms. MOORE. It is similar.

Mrs. MALONEY. I am also concerned about the number of magazines that folded in the district that I represent. What were the dynamics involved with the decisions for some that had been around for 75 years or more?

Ms. MOORE. When postage costs rise, it is our single largest expense item and we run around and examine every aspect of what else we can trim. A magazine can only shrink so small. You have probably seen most of your national magazines go down in size. We have a lot of thanks to give to the paper industry because they have done a marvelous job of developing lightweight papers to take the weight of magazines down until paper is almost transparent. We have cut back on direct mail, which reduces the mail volume. We encourage subscribers to pay by credit card so we do not have to bill you ever again and send out a first class bill. And then when all else fails, we raise our prices and disappoint most of our readers.

In regard to the number of magazines folding, the economics of the magazine business has been just tough. In a soft economy when your advertising revenue stream is soft, these three price increases over 18 months really broke the back of some of the great brands in publishing. It prevents me from really giving a green light to a few new exciting ideas because of the uncertainty of what it costs to launch a new product and create new jobs.

Mrs. MALONEY. Would you like to comment, Mr. Critelli? What does your company do in response to the increasing prices of postage?

Mr. CRITELLI. It hits us in a lot of different ways. We are probably less affected immediately than some of the other CEOs who are here affected. One of our growth areas has been the small business mailer. We have added 350,000 small businesses to our customer base in the last few years. We are up to 825,000. Our main pitch to these businesses is using the mail to grow their business and using our technology to help do that. When they are moving away from mail because mail prices have gone up at a double-digit rate, it hurts our ability to get that small business customer, and that is one of the most profitable parts of our business. It accounts today for about 16 percent of our total profit, our small business U.S. customer base. So that is an area that I think would be hit. Our enterprise customers shut down mail rooms. They shut down print centers. We lose employees and we lose revenues. Over the last few years, we have seen that hit harder, since particularly with the two big postal rate increases we were hit very hard in our management services billings. That is just beginning to come back now.

Mrs. MALONEY. You all mentioned that if they had an outside governing board that would give them ideas and work with them. I am sure they would be open to having ideas, but how would you make that happen? All of you would be great on it, but you probably do not have time to do it. So you are recommending something that is very hard to implement, really.

Mr. WILLIAM DAVIS. I am not sure that is fair to say. I suspect that many of us, if not all of us, including on the next panel, already do serve on at least one other public company board and that is exactly the role we play on those. So I am not sure that it would

be any more difficult to get qualified people with various executive experiences and marketing and operating experiences to serve on a properly structured board for the U.S. Postal Service than I have getting a new director for R.R. Donnelley.

Mrs. MALONEY. Would you be willing to serve on a properly constructed advisory board for the Postal Service?

Mr. WILLIAM DAVIS. The answer is that I probably would. Yes, yes, properly constructed, yes.

Mrs. MALONEY. Would you, Mr. Morris? You created a business that is growing. The Postal Service could use some of your ideas.

Mr. MORRIS. I would be more than happy to participate in any way I could add value.

I think there are two issues going on here. One is an issue of governance and what is the best way of dealing with that. I think that is a lot about what you have heard about transparency, about accountability, and about hiring and firing capability from an independent, involved board. I think those are some of the characteristics that I have seen to be really effective in governance. The issue of ideas and innovation I think is extremely interesting as well.

Mrs. MALONEY. And technology, as you all emphasized.

Mr. MORRIS. Yes. I think that you have within the Postal Service a huge asset, a reservoir of ideas, some of which are coming to the surface; some of which are not. I think there is a real investment that is necessary in people and training and people development around the skills that are necessary to compete. But I think there is no shortage of people in industry, and we are all here today because we care very much about the success of the Postal Service. There is no shortage of people who are willing to support ideas and support the Postal Service in getting to where it needs to get because we participate in that success. I am not going to speak for the other members of the panel here, but I for one would be more than happy to participate in any way where I could add any value.

Mrs. MALONEY. Thank you. My time has expired. Thank you.

Mr. MCHUGH. You are welcome.

Mrs. Blackburn.

Mrs. BLACKBURN. Thank you, Mr. Chairman.

I definitely want to say thank you to each of you for helping us as we look at the proper way to create a structure and environment in which the Postal Service can be viable and competitive and meet the needs that they are there for the public.

Mr. Morris, one quick question for you, and then I have a couple of general questions that I would like for each of you to answer. Your negotiated service agreement, you mentioned the amount of time and energy that went into that. Last week when we had our hearing, we talked at length about the lack of an updated business model for the Postal Service, and the fact that this has gone 30 years without attention, which is a shock to many of us that have come from the private sector, and the opportunities that exist for the Postal Service that we would like to see them take advantage of in creating a more businesslike model for their operations.

My question to you is, in establishing your NSA, did you reach out to the Postal Service and initiate the contact or did they come to you and suggest?

Mr. MORRIS. I can't definitively answer that because I was not there during the early engagements. I can find that out and I would be more than glad to get back to you on that in writing.

Mrs. BLACKBURN. I would love to know that.

Mr. MORRIS. Let me say this, though, about the NSAs, if I can. To us, it is a resounding success and I think it is a win for the Postal Service and it is a win for Capital One. I think there were a lot of well-meaning people at the post office who burned a lot of midnight oil making this happen and we are very grateful to them for that. We were hoping that our NSA would lead to a clear signal for many other companies to engage and to be able to pull off similar arrangements, because I think there are palpable win-wins for everybody.

Sadly, that has not happened. As I attempt to comment on that, I think one, a clear signal and unequivocal endorsement from Congress that says, "Postal Service, we not only would like you to do this, we need you to do this," I think would be helpful within the ranks and apparatus of the Postal Service.

Second, the post office I think needs to really work hard to streamline its processes to enable and to encourage these kinds of actions, and to be out there, as may be embedded in your question, to be actually out there marketing these kinds of arrangements, that say let's create win-wins, and I think that we heard that from other panelists. I think we are a long way from that, but I think it is entirely possible in this huge value that could be created if we were able to do that.

Mrs. BLACKBURN. Thank you, sir.

I would like to have an answer from each of you on this. Last week, we talked some about the Postal Service expending over 80 percent of its revenues on its labor costs, and looking at its labor costs, with the need to bring this down. I would like to hear from each of you just an estimate, a very quick estimate, of what your company spends on labor.

Mr. Smith, we will begin with you.

Mr. SMITH. I believe that our labor costs as a percentage of the whole are a little less than half.

Mrs. BLACKBURN. Thank you, sir.

Ms. Moore.

Ms. MOORE. That is a hard question. I would guess it has to be more than 50 percent, but I would have to check and submit it on the record. Certainly we are a labor-intensive business like the post office, because I do not own any equipment. I print all my magazines on Mr. Davis' presses. So it is a lot of people. It has to be more than 50 percent, but I would have to check for you.

Mrs. BLACKBURN. Thank you.

Mr. Critelli.

Mr. CRITELLI. We have two lines of business, product businesses where the number is relatively low, probably it is well below 50 percent; and our management services business where it is up in the 55 to 60 percent range. Company-wide, it is a little bit over 40 percent.

Mrs. BLACKBURN. Thank you.

Mr. Davis.

Mr. WILLIAM DAVIS. Again, we also have two businesses, but the main commercial printing business, it is about 30 percent; in our services business, like our graphics, arts, pre-media development businesses it is north of 50 percent. The total is in the 30's.

Mr. MORRIS. Labor is a big component of Capital One's business, but I think the last time I looked at it, it is a little less than half of our entire cost structure.

Mrs. BLACKBURN. OK. Thank you very much.

May I ask one closing question?

Mr. MCHUGH. You may.

Mrs. BLACKBURN. Mr. Chairman, that is fine. I will submit it in writing.

Mr. MCHUGH. I would only say to the gentlelady we have a couple more people and we do have another panel.

Mrs. BLACKBURN. Yes.

Mr. MCHUGH. If she could submit that in writing, that would be great. I thank her for her consideration.

Mr. Schrock.

Mr. SCHROCK. Thank you, Mr. Chairman.

Thank you for being here today. I want to do a followup on something Mrs. Miller asked, and that is about the price stability. Virtually everyone is asking for price stability and pricing flexibility, but how do we give the post office more ability to change their rates, but give the customers the predictability they need? And can it be based pretty much on an inflation-based cap? Let me ask Ms. Moore and Mr. Morris.

Ms. MOORE. I absolutely believe it is possible. It sounds contradictory, but if you are working with a cap, you can work under that cap. What is interesting about pricing flexibility that they currently do not have is they do not have the ability to incent me to behave well. I should pay more if my direct mail piece cannot be sorted by a machine. I should be incented to do a lot of prepalletization as we do at our printing press. Right now, for a variety of factors, it bothers me that I, even being the largest publisher, do not always prepare the mail in the most efficient way because the current pricing inflexibility does require me to put my magazines in very inefficient sacks. So that flexibility to incent my behavior will really drive costs out of the post office. He ought to be able to do that under some sort of CPI cap. Right now, if he wants to raise his prices, it takes, like everything, more than a year and that is too long for a business in this century to be strong. So it is very doable.

Mr. SCHROCK. Mr. Morris.

Mr. MORRIS. Could I start by saying that I think a methodology that says we are going to raise prices by inflation is very challengeable as a methodology, and one that in the business world we would never endorse. I think there is a need for the Postal Service to really understand its cost structure at a much more granular level, by product, on a fully allocated basis, understanding the difference between fixed and variable costs. I believe there has been a lot of progress made over the last couple or 3 years in that space, but I think there is a long way to go. Armed with that, you then can say, "I understand what my costs are for this product and I can then look for this kind of margin on top of that product," and

you can test to see if the market is willing to pay that price for that product. If the market is not willing to pay, it may be a business that you should not be in. If the market is willing to pay, then I think you have the chance of building something. Armed with that basic understanding of costs, you also have the ability to incentivize your partners, your customers, in ways to help you reduce that cost and have them have the opportunity to share in the collective bounty that comes from that. Without understanding rigorously your cost structure, you may be giving things away or you maybe not incentivizing enough. So that is I think a real core.

I think second, there is a need to really embrace this notion of custom pricing around seasonality, as we heard a second ago, around promotions, and around the customer that you are dealing with. Are you dealing with somebody who is mailing a lot or a little? Are they mailing third class or first class? Have they been around for 10 years or 2 years? Can you return the mail by physical means or by electronic means? There are enormous amounts of flexibility that one needs to embrace there.

Last, from a governance perspective, I think a 1-year turnaround or longer through quite a Byzantine process does not enable one to be able to do those things effectively. So I think there is a need to embrace some sort of managerially oriented pricing committee with clear boundaries as to what is allowable and what is not in the public policy interest, but giving flexibility at the line of scrimmage to be able to make those calls.

Mr. SCHROCK. Mr. Critelli, how can the postal system most effectively partner with the private mailing companies to lower costs and improve efficiency?

Mr. CRITELLI. I will comment on one piece of it, which is the partnership we have established with the industry to automate and pre-sort mail. Over half of the mail stream today, or pretty close to half, I do not have the exact data, is automated in some way. Activities, in addition to sorting, are done by that.

As an example, we put the payment evidencing on the mail to save the Postal Service from doing that. We cleanse and correct addresses on the fly. We transport the mail so that it is downstream and it avoids steps in the postal process. But I think probably one of the bigger partners of the Postal Service would be in terms of a very effective partnership would be FedEx, so I would like to defer to Mr. Smith and have his comments on this issue as well.

Mr. SCHROCK. Mr. Smith.

Mr. SMITH. It is really pretty simple about how you do these things in the broadest terms. That is, you simply need to take work out. Wherever that is possible, the management of the Postal Service ought to have the authority to quickly, decisively and cooperatively develop win-win pricing for their business partners, whether it is a customer or a supplier, which is what we are. I think if you follow that very simple formula, then there will be all sorts of creative things that the wonderful people in these organizations and the Postal Service, I mean, they have a very talented management team over there if they were given the flexibility to deal with these issues.

Mr. SCHROCK. Yes, I agree. Just one final comment, we hear the term "universal mail service, universal mail service." To me, "uni-

versal" means anything the traffic will bear, including the sale and mailing of used cars if they want to. Mr. Critelli, you came as close as I think it is, and you said in your summary here, the functions of the Postal Service are accepting, collecting, transporting, sorting, and delivering physical mail and packages, period, end of story. What do you think "universal mail service" is? Each of you?

Mr. SMITH. There is a long history on this, of course.

Mr. SCHROCK. Give me the short answer, then. [Laughter.]

Mr. SMITH. I just wanted to preface that because you have to take the literally centuries-old concept of universal communications and the postal monopoly which is built around that, and separate that a bit from moving things. Now, that battleground as to what is a postal monopoly communication or a letter, and what is a thing the private sector can compete in has been the source of a lot of battlegrounds for a long time.

Mr. SCHROCK. Right. It sure has.

Mr. SMITH. The practicality, though, has solved the issue. When you really look at what the Postal Service can do in its delivery system, and that is what dictates its capabilities, it really can handle things a couple of pounds or less. Now, if you want to stretch that to 4 pounds, 5 pounds, maybe, but beyond that they simply do not have the infrastructure to do it. In fact, when you get into vertical urban markets, they actually separate the smaller items and give those to the letter carriers, and have a separate delivery force for anything heavier.

So the private sector is really predominant in above 2 and 4 pounds, that general category, depending on whether it is urban or not, and below that is where the Postal Service has a tremendous density of deliveries, access to mail boxes and so forth. So whatever the universal service obligation, it really is down in that lighter weight area, publications, magazines, advertising, credit cards, things of that nature.

Mr. SCHROCK. Right. Thanks.

Ms. MOORE. I thought that the Presidential Commission defined it well. What it means, the universal service obligation, what it means to me is very reliable, affordable delivery to every household of mail and small parcels and small objects. What I would really like to see is for the post office management to be relieved of the burden of trying to get into other businesses. They should stay very focused and do it very well.

Mr. SCHROCK. Bingo. Yes.

Mr. CRITELLI. I would agree with the last comment that Ann Moore made, which is the comment about focusing on the core business. What we have seen overseas are post offices getting into electronic mail, electronic bill presentments, certificate authority, and a lot of other businesses that they don't really have the core competencies to excel in, and they have stifled private sector and other innovation in those businesses in that process. Focusing on what they do best and giving them the freedom in the area of the monopoly to experiment for public benefit is what I believe this is all about, and growing mail as a vital communications medium.

Mr. WILLIAM DAVIS. I concur. I think by "universal mail service," it means service to everybody on a periodic basis. Regarding what we deliver through the USPS, it is the stuff we do deliver today.

I agree with Mr. Smith that parcels over 4 or 5 pounds make no sense. As a matter of fact, let the record show, the USPS only delivers, this is I think 2-year old data, 1½ year-old data, only delivers to the home 29 percent of the parcels that are delivered to the home, and in total only 11 percent of the parcels. So there is plenty of competition out there because of their own limitations.

Mr. SCHROCK. Thank you.

Mr. Morris.

Mr. MORRIS. I have nothing to add.

Mr. SCHROCK. OK. Thank you all.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman.

We have one more questioner, a very distinguished member of both the full committee and the panel. I would remind the panel, you have a very important meeting that began 2 minutes ago. So with that, I would defer to the gentleman from Missouri.

Mr. CLAY. I thank you for yielding, Mr. Chairman, and I thank the panel for being here, sharing their time and their observations on this important subject.

Let me start with Mr. Smith. I like to expedite things, so let's start with FedEx. The Postal Service is not a government entity, but it also is not a private entity. Instead, a number of special laws govern its operations, such as a statutorily mandated rate-setting process and a requirement that the Postal Service break even. What are some of the biggest handicaps the Postal Service faces that we need to change?

Mr. SMITH. I think you need to have the regulator dictate the universal service obligation that you decide is appropriate, and have then the Postal Service management delegated the flexibility to manage against that obligation in whatever way they see fit. And then in those sectors which are competitive, the regulator should simply ensure that there is no cross-subsidization and that there is a cap on the pricing in the competitive arena or an appropriate mechanism to see that funds do not flow from the monopoly business over to the competitive business. Those are the two essential features of whatever you do or ought to be in our opinion.

Mr. CLAY. One part of the business subsidizes the other one, is what you are saying.

Mr. SMITH. No, it should not be permitted to subsidize the other. That is the point. It gets back to this focus, because at the end of the day, there is no entity that can really provide universal service for these smaller items other than the Postal Service, at an affordable price.

Mr. CLAY. Thank you, Mr. Smith.

Just out of curiosity, is there any truth to the folklore that you got the concept of FedEx by trying to overnight a term paper to a professor?

Mr. SMITH. I think where people talk about it, they laugh about the fact that I got a C grade on that paper, and since I have taken the oath here, I must inform you that was an extremely good grade for me, and I was very happy with it. [Laughter.]

Mr. CLAY. Thank you for that comment.

Ms. Moore, you indicated that the current business model of the Postal Service is not sustainable. Would you explain your reasoning on that statement?

Ms. MOORE. That is just because the volume continues to plummet downward. I will admit that in the early 1990's, we could see this coming. We did, you know, form with several other companies an alternative to the post office. We tested alternate delivery with a company called Publishers Express, and we actually delivered magazines and catalogs, starting in the State of Georgia, to about 32 cities throughout the country. We proved to ourselves that you could run a business. We did actually break even in 1 month, I think, but we closed the business in 1996 because it was clear that the sustainable business was only to upscale zip codes in America, which happened to be where most magazines are delivered, and it did not seem good for the country that we, a big client, would leave and develop such an exclusive business. But I think that experiment in the early 1990's proved, at least in my mind, that this is very doable to stop this volume decline and these runaway costs, if we just practice good business.

Mr. CLAY. Thank you for that answer.

Mr. Critelli, your statement indicated that the Postal Service mission needs clarification to be accomplished. Do you feel that there is ambiguity in the current mission statement?

Mr. CRITELLI. Yes, I do, Congressman Clay. I think the Postal Service, especially if you go back into the 1990's, tested the limits of the mission statement by moving into several, what I think all of us would say, would be non-core businesses, and did not succeed at those businesses, but felt it had the freedom to do that, and did not have, I think, a clear direction that its mission is to make mail as affordable as possible.

I would agree with Ms. Moore's comment. Again, I would reiterate her comment about focus. The Postal Service is the best at delivering magazines. If it came to the conclusion that it could promote more magazine publications by lowering its rates, as opposed to being locked into this death spiral that lower volumes mean higher rates, I think that would be for the public good. I think the Postal Service needs to get clarity that it is OK to do that. I don't think it believes today that it can do that. I think it is very locked into when its costs go up and its volumes go down, it has to do the counter-intuitive thing, which is to raise prices to cover the costs, rather than figuring out how to grow the volumes to cover those costs.

Mr. CLAY. OK. Thank you for that answer.

Mr. Davis, in your testimony you talk about the importance of service performance standards. One thing about the Postal Service that somebody said, it is a 200 year-old tradition. People look forward to receiving their mail on a daily basis. It is still a pretty good bargain at 37 cents for first class mail. Would you care to elaborate on the idea of what kind of performance standards?

Mr. WILLIAM DAVIS. My concept on performance standards in any business in any organization is that, frankly, if you cannot measure and do not measure something, you will not do what you should do. I believe that in anything that is important for the Postal Service, they ought to establish metrics and they ought to hold

themselves accountable for it. That is one of the roles that my concept that the board would have.

Mr. CLAY. OK. Mr. Morris, please explain why the Postal Service should only be allowed to focus on its core competency, which is universal service. Shouldn't the Postal Service look for additional innovative revenue enhancement opportunities? Let me just hear your thoughts on that, please.

Mr. MORRIS. Thank you, Congressman Clay.

I do believe that there is a significant opportunity for the Postal Service to be much more innovative and ingenious in terms of its business model. I do, however, on the other hand believe that there is a need for disciplined focus around where there is a core competitive advantage, using business-speak. I think it is perfectly reasonable to recognize that you are good at some things and you are not good at others. In recognizing that you are not good at some things, you are willing therefore to be able to form partnerships with others who can do that better than you and you manage those vendor relationships. Everybody on this panel is doing that, and I think the Postal Service could look at that, too.

In terms of exactly what businesses the Postal Service should be in and which ones they should not be in, I do not feel qualified to specifically articulate. I would say that the Postal Service does have some tremendous core assets. As you mentioned, it has the universality of delivery, it has the last mile, and it has an incredible brand. I think those are very valuable things to build around. It also has relationships with just about every corporation in America.

So I think that there is an opportunity to take a step back in a disciplined innovation process to look at what things might be able to work and which ones might not, and be willing to experiment, rather than invest everything in big-bang ideas. I think there is a lot of learning and a lot of development here, and a long way to go.

Mr. CLAY. Thank you for your answer. I thank the entire panel for their answers.

Thank you, Mr. Chairman.

Mr. MCHUGH. I thank the gentleman.

Lady and gentlemen, thank you so much for your patience over 2½ hours. As I said, I know you have another meeting to go to. I deeply appreciate your effort to be here and your contributions. We look forward to working with you. God bless you.

While they are moving on, let's call the second panel.

If I could call us back to order. It is my honor to introduce our second panel. Let me start by thanking them for their patience. I mentioned how the first panel devoted 2½ hours. The second panel has devoted 2½ hours and has not had the opportunity until now to appear and to testify. So thank you so much for that.

As was the case in the first panel, we are very honored to have a very distinguished second panel. If I may introduce them as they are listed here: Mr. Lester Hess, chairman, Grand Lodge Advisory Committee, Benevolent and Protective Order of Elks, or as I know it, the Elks Club, thank you so much for being here; Hamilton Davison, who is chief executive officer of Paramount Cards, Inc.; Rebecca Jewett, president and chief executive officer, Norm Thomp-

son Outfitters, Inc.; and Mr. Gary Mulloy, chairman and chief executive officer of ADVO. Our most heartfelt thanks and congratulations for your interest and for being here today.

As I noted on the first panel, we do have your written statements, and without objection those will be entered into the record in their entirety. As we did request for the first panel, to the extent possible if you could summarize those comments so that we could get right to the dialog, it would be greatly appreciated.

Welcome, and with that I would ask you to present your testimony in the order in which we introduced you.

Mr. Hess.

Mr. HESS. Thank you, Mr. Chairman.

Mr. MCHUGH. You know what? I deeply apologize. It is absolutely nothing personal, but committee rules provide that we do have to swear you in. So if you will stand and swear with me.

[Witnesses sworn.]

Mr. MCHUGH. It has been a long day. I knew they would tell the truth anyway, but parliamentarians are sticklers. The record will show all four panelists responded to the affirmation in the positive. With that, again my apologies Mr. Hess, our attention is yours, sir.

STATEMENTS OF LESTER HESS, CHAIRMAN, GRAND LODGE ADVISORY COMMITTEE, BENEVOLENT AND PROTECTIVE ORDER OF ELKS; HAMILTON DAVISON, CHIEF EXECUTIVE OFFICER, PARAMOUNT CARDS, INC.; REBECCA JEWETT, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORM THOMPSON OUTFITTERS, INC.; AND GARY MULLOY, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, ADVO, INC.

Mr. HESS. Thank you, Mr. Chairman.

I am chairman of the past national presidents of the Elks of America. The Elks are a nonprofit fraternal organization of slightly more than 1 million men and women. We service more than 2,200 communities located in every State across the Nation.

For 136 years, the Elks have promoted charitable and patriotic programs in all the communities where we are located. As an example, volunteers from the Elks visit the patients in every one of this Nation's 163 Veterans' Administration medical centers every month throughout the year. They hand out phone cards. They do things like give canteen coupons away, personal hygiene items. They conduct parties, and from time to time they invite many of these hospitalized veterans to events such as Thanksgiving dinners at Elks facilities.

Last year, a national survey showed that more than $200 million were earmarked for Elks charities in terms of both cash and the value of service contributions. The Elks are only one of several hundred members of the Direct Marketing Association nonprofit federation. I wish to thank the committee for giving me the opportunity to speak on their behalf regarding our views of the future of the Postal Service in light of the President's recently announced principles.

The nonprofit community is vital to the well-being of our Nation. Indeed, these nonprofit organizations are woven into the very fabric of American life. To a large extent, they depend upon the U.S. mail, particularly nonprofit standard and periodical mail, for their

existence. The Elks recently used the U.S. mail to get donations from their members totaling more than $1 million for the World War II memorial that is going to be dedicated here in May.

That is why we in the nonprofit world are vitally concerned with your efforts to shape postal reform. Since 1970, nonprofit mailers have seen an escalation in rates which at times has caused us to think about cutbacks in our charitable programs and our services. Since 1970, postal rates for nonprofits have increased more than 1,600 percent for periodicals. Commercial periodicals increased 558 percent during the same period.

The cost for us to mail more than 1 million copies of the Elks Magazine each month has increased nearly three times the increase for commercial publishers. Although nonprofit postage is now fixed at a discount to the commercial rate, and we do not expect the gap to widen, we do recognize the need for postal reform that will allow for rate increases, but not a pure unlimited pass-through of costs to rate-payers. We simply seek a measure of stability for our rates. We would encourage you to establish some form of indexing so that, for example, a rate increase could not exceed the rate of inflation unless truly extraordinary circumstances existed. Otherwise, the nonprofits of this country are going to be impacted in their ability to continue doing their good deeds.

There is the immediate crisis I want to briefly address, and that is the escrow fund issue. We agree that money could more properly be used for operational expense and to reduce debt. That translates into an increase in postal rates for us if the escrow is left in, that could be in the double-digits by 2006. The Elks and other nonprofits simply cannot absorb double-digit increases without looking to cut some services. For the Elks alone, double-digit increases would cause us to reexamine a number of our charitable programs such as summer camps for children who are financially disadvantaged or have physical disabilities, to say nothing of the volunteer work that we do at the VA facilities.

In addition to the need to revisit the escrow requirement in the 2003 law, we also agree that the military pension issue ought to be revisited. If this responsibility is transferred back to the taxpayers as it was before via the Department of the Treasury, the impact of postal rates on us is obviously going to be less severe.

Finally, I want to stress that the Elks, as well as all of the others like us in the Direct Marketing Association Nonprofit Federation, will continue our good works in support of government, regardless of the direction of postal reform. If you call on us, we will be there. However, you can help us perpetuate our charitable work by adopting appropriate and fair postal reform.

Thank you.

[The prepared statement of Mr. Hess follows:]

1
2
3
4 Testimony
5
6 by
7 Lester C. Hess, Jr.
8 Past National President,
9 Chairman of the Grand Lodge Advisory Committee,
10 Benevolent and Protective Order of Elks
11 of the United States of America
12
13
14 Before the
15
16 Special Panel on Postal Reform and Oversight
17 Committee on Government Reform
18 U.S. House of Representatives
19
20 February 11, 2004
21

21

22 I am Lester C. Hess, Jr., Chairman of the Elks Grand Lodge
23 Advisory Committee and Past National President of the Elks,
24 known in total as the Benevolent and Protective Order of Elks
25 of the United States of America. I am also a Trustee of the
26 Elks National Foundation and serve as the State Sponsor of
27 Kentucky, Virginia, and West Virginia Elks.

28

29 The Elks are a nonprofit fraternal organization of 1.1
30 million women and men who serve more than 2,200 communities
31 across the nation. Its headquarters are located in Chicago.
32 For 136 years, the Elks have pursued this mission: to in-
33 culcate the principles of charity, justice, brotherly love, and
34 fidelity; to promote the welfare and enhance the happiness of
35 mankind; to quicken the spirit of American patriotism. In
36 2003, a survey of Elks activities identified more than $200
37 million annually that had been allocated for charitable,
38 educational, welfare, and patriotic programs in terms of both
39 cash and value of service contributions. Cumulatively this
40 amounts to over $3.5 billion since tracking began in 1878.

41

42 In addition to my commitment to the Elks, I am active in
43 the work of other nonprofit organizations. I have served as
44 President of the Board of Governors of the Alumni Association

45 of the West Virginia College of Law. For 32 years, I have been
46 a member of the Board of Trustees of the Ohio County, West
47 Virginia, Public Library, and for the last ten years, I have
48 chaired that board.
49
50 I was a founder and chaired the Board of Directors of Big
51 Brothers-Big Sisters of Wheeling, Inc., in Wheeling, West
52 Virginia. I am a member of the Vance Memorial Presbyterian
53 Church also in Wheeling.
54
55 Our organization is a member of the Direct Marketing
56 Association Nonprofit Federation ("DMANF"), which represents a
57 broad cross-section of the nonprofit community eligible to mail
58 at the nonprofit mail rate.
59
60 I wish to thank the Committee for giving me the
61 opportunity to provide our perspective on the future course of
62 the Postal Service in light of the President's Commission on
63 the Postal Service's recommendations and the President's
64 recently stated objectives for postal reform.
65
66 Over the past thirty-four years nonprofit mailers have
67 experienced a sporadic escalation in rates which forces the
68 choice of cutting-back charitable programs and services. We

69 encourage reform that will allow rate increases, but not an
70 unlimited pass-through of cost to rate payers; instead, reform
71 focusing on a balanced, managed approach to provide service and
72 value. It is important to note that nonprofit mailers have
73 paid their own way and have contributed to the Postal Service's
74 overhead without receiving any Congressional subsidy since
75 1998.
76
77 We agree with the United States Postmaster General's
78 assessment in his earlier testimony that productivity
79 improvements of the last few years, coupled with reduced
80 pension payments resulting from recent legislation, have masked
81 the need for legislation. The general public is largely unaware
82 of the potential death spiral of the Postal Service due to its
83 declining volume and its increasing costs. But we know through
84 our own experience that the time for change is today, before a
85 crisis forces our hand.
86
87
88 **Overview of the DMA Nonprofit Federation**
89
90 The Nonprofit Federation's more than 350 members consist
91 of nonprofit religious, educational, and charitable

92 organizations and professional fund raising consultants with
93 particular expertise in direct response fund raising.
94
95 The nonprofit mailers that make up the DMANF
96 membership are a broad cross section of the more than 200,000
97 nonprofits that are authorized to mail at the nonprofit rates
98 of postage.
99
100 Altogether, Nonprofit Standard-class mailers account for
101 about 14.5 billion or 7.2% percent of total mail volume, often
102 in the form of fundraising mail, educational material,
103 newsletters and event promotions. Nonprofit Periodicals like
104 The Elks Magazine amount to about 2 billion pieces or 1.0% of
105 total annual mail volume.
106
107 The Federation membership consists of very large national
108 organizations whose names are household words; smaller but
109 still good-sized nonprofits with a high level of name rec-
110 ognition nationwide; and medium-sized, small, and local
111 nonprofit organizations, even individual churches and
112 synagogues.
113
114 The nonprofit community that the DMANF represents is vital
115 to the well being of this nation both at this very moment and

16 in the future. These organizations are committed to provide
17 safety net of social and spiritual services, to support
18 education, and foster the arts and science without any
19 government funding or in the face of government cutbacks.
20
21 The United States Mail, particularly Nonprofit Standard
22 and Periodicals Mail, is the lifeblood of these organizations.
23 Nonprofits use the mail to solicit contributions from members,
24 the public, disseminate news and information, and communicate
25 with donors, members, and the public at large.
126
127 Nonprofit mail rates also assisted charities, churches,
128 colleges and universities to fill the gap left by shortfalls in
129 federal and state funding for social programs and education.
130 The federal government is now counting on this Nation's
131 nonprofit community to step-up again as national priorities
132 focus on security at home and abroad. Americans will be left
133 without vital services unless the longstanding federal policy
134 of affordable mail rates is preserved for nonprofits with
135 missions that benefit the public good. It is for this primary
136 reason that we respectfully submit the following comments.
137
138

138 **Postal Reform: Key Elements**

139

140 The problems posed by the Postal Service for this
141 Nation's nonprofit service-oriented community requires both
142 long-term reform and immediate action.

143

144 I commend this Special Panel and the leadership of the
145 full Committee on Government Reform in the House of
146 Representatives for its decision to hold hearings on the
147 recommendations of the President's Commission on the U.S.
148 Postal Service and the President's principles of reform.

149

150 In addition to the President's guiding principles for
151 reform, we would add the following:

152

153 Rate increases alone will not be sufficient to preserve
154 universal service and prevent deterioration of service--let
155 alone improve the reliability of service.

156

157 Since 1970, postal rates have been set to cover the direct
158 cost to process each class of mail and the Postal Service's
159 overhead costs. Postal management is constantly trying to
160 improve its methods to make sure that it collects good cost
161 data and allocates its costs correctly by class of mail.

162

163 Since 1970, postage increases have been enormous for
164 the nonprofit community (**See Attachments A & B**). The Elks use
165 the nonprofit mail rate to communicate with members through The
166 Elks Magazine, the central vehicle to connect the membership on
167 a national basis; to make local Elks Lodges aware of charitable
168 and patriotic activities at Lodges just like theirs around the
169 nation; and to join us together in love for this country
170 regardless of our regional differences.

171

172 For the past 34 years, the Elks Magazine has had to cope
173 with cumulative postage increases in excess of 1,600 percent.
174 In contrast, single piece First Class postage increased about
175 516 percent during that same period, and commercial
176 publications only 558 percent in postage increases. Thus, the
177 Elks magazine postage has increased more than three times
178 higher than First Class Mail and more than twice as high as
179 commercial publishers. Much of the reason for the increase was
180 a shift from federal appropriations for revenue foregone to
181 mailers, mostly nonprofits, with some impact on commercial
182 mailers as well. This increase has been dramatic and stark
183 compared to normal increases in costs for other essential needs
184 of our organization over this same time period.

185

186 As we view this past history, we remain cautious in our
187 approach to reforming the United States Postal Service. We urge
188 that as Congress moves forward in reform and considers capping
189 rates for our type of mail, a serious examination of the price
190 cap proposal occur.
191
192 Congress needs to ensure that if rates are capped for
193 nonprofit mail that they remain capped. Rates should not
194 continue to increase because of new conditions without a
195 significant process of review or challenge by impacted mailers
196 as with current rate proceedings.
197
198 We expect the Postal Service will aggressively seek rates
199 beyond a cap limit for those rate categories they have proposed
200 accelerated rates in the past, namely Nonprofit Periodicals, as
201 their priorities shift and economic realities tempt the Service
202 to raise rates rather than take other steps.
203
204 We seek certainty and stability for our rates with the
205 same expectation as other types of mailers who champion reform.
206 We urge Congress to ensure there is no hidden escape hatch for
207 the Postal Service after rates are capped that would lead to
208 rate shock for nonprofit mailers and would weaken the price cap
209 scheme.

210

211 No one would disagree that affordable postal rates for
212 charities is a core reason for today's mission of the Postal
213 Service as captured in its universal service mandate.
214
215 As Congress moves forward with important reforms that
216 impact universal service, we need to be wary of potential
217 consequences for our organizations.
218
219 No doubt, rate increases produce deleterious consequences.
220 Suffice it point out that at any given rate of increase, some
221 mail will be priced out of the system. Volume declines beget
222 new postage rate increases which perpetuate the so-called
223 "death spiral." We urge the Committee to act now so that the
224 Elks mail and other nonprofit mailers are not swept into the
225 death spiral.
226
227 In fact, the General Accounting Office has reported that
228 it will take much more than raising postal rates even higher i
229 order to set the Postal Service on a sound economic foundation
230 for the long run:
231
232 In order to achieve net cost savings, the Service's
233 cost-cutting efforts must currently offset billions

234 of dollars in annual cost increases for general wage
235 increases, cost-of-living adjustments, and rising
236 benefits costs, particularly in health insurance pre-
237 miums, as well as infrastructure and workforce
238 costs associated with having to deliver mail to
239 over 1.5 million new addresses every year.
240 Thus, maintaining the quality and affordability
241 of postal services would likely require dramatic
242 improvement in the Service's efficiency. In order
243 to do so, the Service will need to become a much
244 leaner and more flexible organization and right size
245 its processing and retail networks and its workforce.
246
247 Statement of David M. Walker, Comptroller General of the United
248 States, United States General Accounting Office, January 28,
249 2004, at page 8.
250
251 If higher rates are the predominant means to address the
252 economic and financial problems that plague the Postal Service,
253 then the rate of those increases will have to be very steep.
254 The ripple effects of successive rounds of staggering postal
255 rate increases will be very destabilizing to the economy.
256

In the last twenty years, postal management has relied increasingly on substitution of automation for labor. This has been a very expensive strategy for flats. One may debate whether their strategy has resulted in net cost savings--it has succeeded for letters, but failed for flats. There is agreement, however, that relying predominantly on rate increases to raise sufficient revenue to pay for a continuation of that strategy and to pay for the Postal Service's other costs is a bankrupt approach.

True productivity means to eliminate the cause of loss and waste--that is improving the reliability of service--without new capital investment. To achieve such productivity will require top postal management to solicit its employees at every level in order to identify those places in the system that cause waste and loss. Only top management has jurisdiction over the system. That's why top management and labor must work together if the Postal Service is to improve productivity without investing new capital.

It is imperative that management achieves productivity without new capital in order to achieve the objectives of postal reform. Otherwise the Postal Service will continue on its present course--raising rates to cover ever-rising costs

281 and new capital investment with the concomitant effect to price
282 more and more mail out of the postal medium.
283
284 **Only Congressional Action Now Will Prevent**
285 **Destabilization in 2006**
286
287 In addition to the need for broad and deep postal reform,
288 there is an immediate rate crisis close at hand that could
289 raise rates by double digits for nonprofit organizations.
290
291 Postage increases will become a destabilizing economic
292 force at the beginning of 2006 unless Congress acts now to
293 address the unforeseen impact of two provisions in P.L. 108-18,
294 the Postal Civil Service Retirement System Funding Reform Act
295 of 2003. The magnitude of the rate impact and the urgent need
296 for action immediately needs your attention.
297
298 Top postal management has apprised mailers throughout 2003
299 that it will need to boost postal revenue by early 2006. As a
300 result, postal economists will begin this spring or early
301 summer to prepare the filing that will initiate the next postal
302 rate case in fall of 2004.

304 Fall 2004 to January 2006 is barely sufficient to conduct
305 the ten-month trial-like rate proceeding and also afford time
306 for the Board of Governors to act on the Postal Rate
307 Commission's recommended decision in the rate case.
308
309 Thus, unless Congress mitigates the increased postage
310 impact that P.L. 108-18 will have on the rate proposal the USP
311 is preparing to file this year, the result will be double-digi
312 rate increases for my organization and charities across the
313 nation.
314
315 We cannot absorb such increases without cutting services
316 to Elks' state-wide charitable programs such as summer camps
317 for children who are financially disadvantaged or with
318 disabilities; in-home disability treatment; children's
319 hospitals; cancer research; eye care; temporary haven for
320 abused families; local, state and national disaster relief;
321 community recognition programs; and Elks national youth
322 programs like "Hoop Shoot" or "Soccer Shoot;" scholarships;
323 drug awareness literature; and veterans service programs.
324
325

325 **The Magnitude of the Prospective Increase**

326

327 Beginning in FY2006, P.L. 108-18 requires the Postal
328 Service to establish and fund an escrow account to hold the
329 difference between the amount of money that the old postal
330 civil service retirement formula would have generated and the
331 new formula set forth in P.L. 108-18.

332

333 Unless Congress acts very soon, postal management will
334 request a postage increase that averages 5.4 percent higher
335 than it otherwise would need in order to fund the mandated
336 escrow fund beginning in 2006.

337

338 The 5.4 percent would come on top of whatever increase
339 postal economists estimate will be needed in order to pay for
340 the higher operating expenses of the Postal Service since the
341 last postal rate increase in 2002. Thus, if postal economists
342 were to determine that postal operations require a modest
343 increase in postal revenue, say two to four percent, then the
344 5.4 percent increase would approximate a double-digit increase.

345

346 If postal economists determine that the Postal Service has
347 been spending at an even faster pace, say five to ten percent,
348 since the last rate increase, then the combined postage

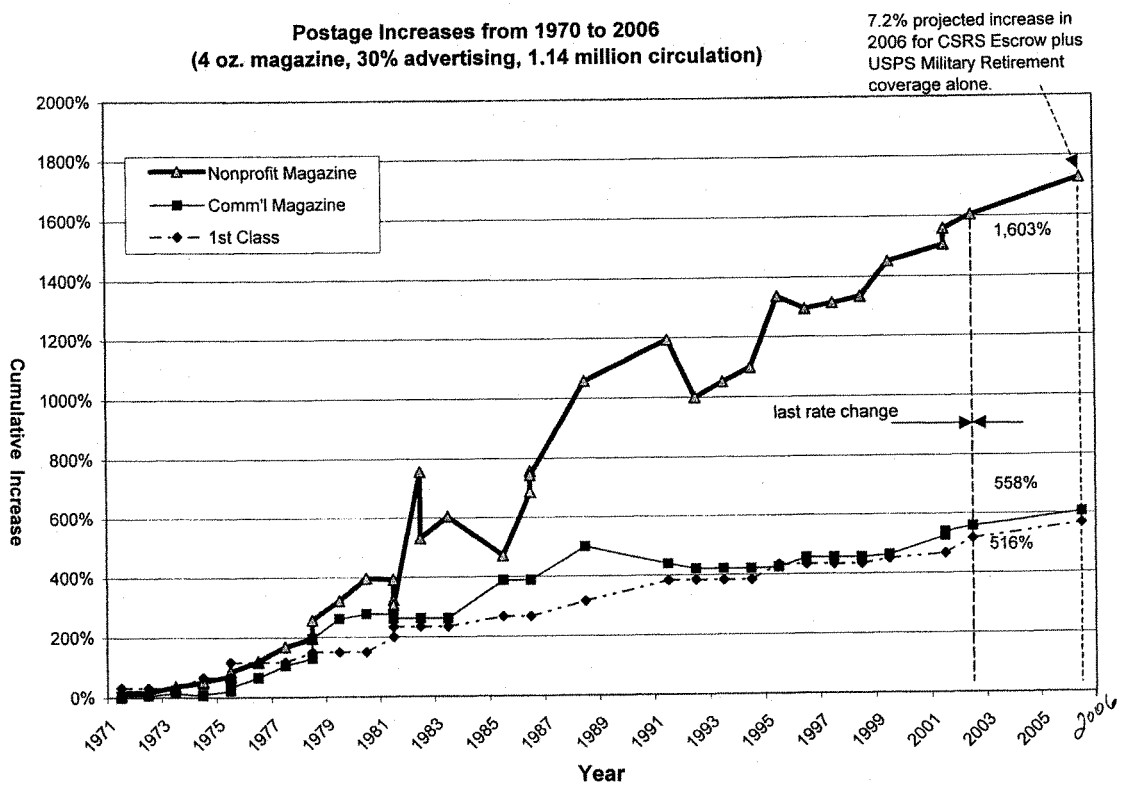
349 increase management requests would average ten to fifteen
350 percent. As unconscionable as that may sound, it is plausible.
351
352 The average add-on increase of 5.4 percent in postage in
353 2006 will be <u>even greater</u> depending on resolution of a separate
354 issue: Who pays for certain federal military retirement costs
355 --all taxpayers or only mailers?
356
357 P.L. 108-18 also transferred responsibility to the Postal
358 Service to pay for the retirement benefits of postal employees
359 earned through military service. Previously, Congress assigned
360 this responsibility to the Department of the Treasury, that is,
361 to all taxpayers.
362
363 **<u>Destabilizing Impact of A Double-Digit Increase in Postage</u>**
364
365 For most mailers, postage is the single largest expense
366 item when it comes to direct mail marketing and publishing.
367 Thus, it is difficult for most mailers to absorb a double-digit
368 increase in postage.
369
370 A double-digit increase in postage is particularly
371 devastating for nonprofit organizations. Nonprofit mail rates
372 are the lifeblood of organizations that provide safety net

373 services, support education, and foster the arts without
374 government funding and in the face of government cutbacks
375 particularly severe this year because of declining budgets.
376
377 As mentioned above, nonprofits use the mail to solicit
378 contributions from the public, disseminate news and
379 information, and communicate with donors, supporters, and the
380 public at large from public health information to results of
381 scientific studies. Despite widespread use of the Internet, we
382 find there simply isn't alternative technology to accomplish
383 these vital functions as effectively for charities.
384
385 Mailers that sell goods and services may be able to offset
386 some of the postage increase by raising the price of the goods
387 or services they sell through the mail. Nonprofits, however,
388 do not sell goods or services and have no way to absorb
389 increases without great harm.
390
391 The only way that nonprofits can respond to higher postal
392 rates is to mail fewer solicitation appeals, cut back service,
393 curtail new programs, and reduce staff. To permit double digi
394 increases now would result in an enormous loss of social
395 programs that provide services not performed by government.
396

397 **Conclusion**

398 As you look ahead to chart the future course of the Postal
399 Service, you must look back.
400
401 For decades Congress has recognized that affordable
402 nonprofit mail rates and good works that nonprofits perform in
403 the public interest go hand in hand. To allow nonprofit mail
404 rates to rise at a double-digit rate would erode the ability of
405 nonprofits to perform good works for which there isn't any
406 substitute provider. That's an important reason why nonprofit
407 mail rates have historically been a good investment for the
408 Nation as a whole.
409
410 You can be certain that the Elks will continue our good
411 works in support of government regardless of the direction of
412 postal reform. If you call on us, we will be there. However,
413 Congress has the ability to set the stage for fostering charity
414 or to shrink our abilities through postal reform. We urge you
415 to help us.
416

Attachment A



Attachment B

	Nonprofit Periodicals				Regular Periodicals				First Class Letter		
	4 oz., 30% advertising, 1.14 million circulation										
Rate Change	Nonprofit Postage	% change	cumulative % chg	cost per copy	Periodicals Postage	% change	cumulative % chg	cost per copy	Single Piece Postage	% change	cumulative % chg
January 1, 1970	$10,280			$0.009	$27,871			$0.025	$0.06		
January 1, 1971	$11,107	8.05%	8.05%	$0.010	$27,871			$0.025	$0.06		
May 16, 1971	$12,122	9.14%	17.92%	$0.011	$29,709	6.60%	6.60%	$0.027	$0.08	33.33%	33.33%
July 6, 1972	$12,040	-0.68%	17.12%	$0.011	$29,919	0.71%	7.35%	$0.027	$0.08		
September 9, 1973	$14,080	16.94%	36.96%	$0.013	$31,794	6.27%	14.08%	$0.029	$0.08		
March 2, 1974	$15,472	9.89%	50.51%	$0.014	$29,845	-6.13%	7.06%	$0.027	$0.10	25.00%	66.67%
July 8, 1974	$15,817	2.23%	53.86%	$0.014	$30,870	3.44%	10.76%	$0.028	$0.10		
July 6, 1975	$17,507	10.69%	70.30%	$0.016	$34,121	10.53%	22.43%	$0.031	$0.10		
September 14, 1975	$17,590	0.48%	71.11%	$0.016	$34,155	0.10%	22.55%	$0.031	$0.10		
December 31, 1975	$19,208	9.20%	86.85%	$0.017	$37,579	10.03%	34.83%	$0.034	$0.13	30.00%	116.67%
July 6, 1976	$22,338	16.29%	117.29%	$0.020	$45,915	22.18%	64.74%	$0.041	$0.13		
July 18, 1976	$22,636	1.34%	120.19%	$0.020	$46,393	1.04%	66.46%	$0.042	$0.13		
July 5, 1977	$27,537	21.65%	167.87%	$0.025	$57,511	23.97%	106.35%	$0.052	$0.13		
May 29, 1978	$30,353	10.23%	195.26%	$0.027	$63,927	11.16%	129.37%	$0.057	$0.15	15.38%	150.00%
July 6, 1978	$36,738	21.03%	257.36%	$0.033	$82,343	28.81%	195.45%	$0.074	$0.15		
July 6, 1979	$43,335	17.96%	321.54%	$0.039	$100,639	22.22%	261.09%	$0.090	$0.15		
July 8, 1980	$51,042	17.78%	396.51%	$0.046	$105,043	4.38%	276.89%	$0.094	$0.15		
March 22, 1981	$50,602	-0.86%	392.23%	$0.045	$105,043			$0.094	$0.18	20.00%	200.00%
July 6, 1981	$43,522	-13.99%	323.36%	$0.039	$105,043			$0.094	$0.18		
November 1, 1981	$41,743	-4.09%	306.05%	$0.037	$100,724	-4.11%	261.40%	$0.090	$0.20	11.11%	233.33%
January 10, 1982	$87,860	110.48%	754.66%	$0.079	$100,724			$0.090	$0.20		
July 28, 1982	$64,828	-26.21%	530.61%	$0.058	$100,724			$0.090	$0.20		
January 9, 1983	$72,355	11.61%	603.83%	$0.065	$100,724			$0.090	$0.20		
February 17, 1985	$58,655	-18.93%	470.56%	$0.053	$136,146	35.17%	388.49%	$0.122	$0.22	10.00%	266.67%
January 1, 1986	$80,651	37.50%	684.53%	$0.072	$136,146			$0.122	$0.22		
March 9, 1986	$88,006	9.12%	756.08%	$0.079	$136,146			$0.122	$0.22		
April 20, 1986	$86,572	-1.63%	742.13%	$0.078	$136,146			$0.122	$0.22		
April 3, 1988	$118,904	37.35%	1056.64%	$0.107	$167,048	22.70%	499.37%	$0.150	$0.25	13.64%	316.67%
February 3, 1991	$132,859	11.74%	1192.39%	$0.119	$150,142	-10.12%	438.71%	$0.135	$0.29	16.00%	383.33%
September 20, 1992	$112,945	-14.99%	998.67%	$0.101	$145,160	-3.32%	420.83%	$0.130	$0.29		
November 21, 1993	$118,228	4.68%	1050.06%	$0.106	$145,160			$0.130	$0.29		
October 2, 1994	$123,074	4.10%	1097.20%	$0.110	$145,160			$0.130	$0.29		
January 1, 1995	$147,641	19.96%	1336.18%	$0.133	$146,167	0.69%	424.45%	$0.131	$0.32	10.34%	433.33%
October 1, 1995	$147,641			$0.133	$146,167			$0.131	$0.32		
July 1, 1996	$143,302	-2.94%	1293.97%	$0.129	$154,951	6.01%	455.96%	$0.139	$0.32		
October 6, 1996	$143,302	0.00%	1293.97%	$0.129	$154,951			$0.139	$0.32		
October 12, 1997	$145,196	1.32%	1312.39%	$0.130	$154,951			$0.139	$0.32		
October 4, 1998	$147,424	1.53%	1334.07%	$0.132	$154,951			$0.139	$0.32		
January 10, 1999	$159,393	8.12%	1450.49%	$0.143	$156,947	1.29%	463.12%	$0.141	$0.33	3.13%	450.00%
January 7, 2001	$164,969	3.50%	1504.73%	$0.148	$174,085	10.92%	524.62%	$0.156	$0.34	3.03%	466.67%
July 1, 2001	$170,383	3.28%	1557.40%	$0.153	$178,127	2.32%	539.12%	$0.160	$0.34		
June 30, 2002	$175,099	2.77%	1603.28%	$0.157	$183,323	2.92%	557.76%	$0.165	$0.37	8.82%	516.67%
January 1, 2006	$187,700	7.20%	1725.85%	$0.168	$196,530	7.20%	605.15%	$0.176	$0.40	8.11%	566.67%

January 1, 2006 is projected to reflect a 5.4% Civil Service Retirement Escrow inclusion, plus USPS coverage of 1.8% Military Retirement.
A no additional increase component was projected, however, 7.2% will be the minimal increase without relief before 2006.

The source of rate inforamation for the above compilation was the paper "Domestic Rate History," organized and made available by the United States Postal Service, Marketing Systems, Pricing. September 2001.

Mr. MCHUGH. I thank the gentleman. I think it is worthy to note that you represent a broad spectrum of charitable organizations that do amazingly effective work, as he outlined with respect to his particular organization. The Elks are so very important, and rely upon the Postal Service for their very existence. So your testimony is particularly appreciated.

Next, we are honored to have Mr. Hamilton Davison, who is chief executive officer of Paramount Cards, Inc. Mr. Davison, thank you so much for being here, and we look forward to your testimony, sir.

Mr. DAVISON. Thank you, Mr. Chairman. Good afternoon, distinguished members. I appreciate the opportunity to present to you here today. My company is an industry leader in what we call value-oriented marketing. I believe value-oriented thinking needs to be imbued into the Postal Service and supported by this panel, as well as this Congress.

Our postal system is in danger and needs a systematic overhaul. You have heard from many interested parties. Because over half of all cards purchased are mailed, my views represent both my company and my industry, but I also believe are reflective of the general wishes of the American public. Without uniform universal access to the mail at a price that people value, the postal system is at risk.

For the most part, I agree with the Commission's recommendations and the President's five principles for reform. We can tweak elements, but the broad strokes are good. In my written testimony, you have some specific recommendations for a postal reform bill. Let me underscore two.

First, a strong, effective regulatory mechanism is vital. So is a congressional mandate for both fairness and cost alignment. You heard that earlier. Protection for the captive postal customer or the average American was a cornerstone of the Presidential Commission. The approach taken in the most recent postal legislation by Representatives McHugh and Waxman certainly accomplishes this.

Second, grant the Postal Service the authority to control its work force and facility costs just as companies do. This is a major concern for me on two levels. First, controlling cost is essential for long-term viability. Second, if the Commission's comprehensive cost control recommendations were enacted, I could accept a rate-setting process that lacks prior review, a position I would not have considered previously.

The Commission also raised the issue of wage comparability, which in my judgment should be resolved. If we are serious about placing the Postal Service on a firm financial footing, this is a seminal question that must be answered before any work force changes are contemplated. This ties directly with the President's call for best practices, transparency and accountability.

I respectfully suggest that the General Accounting Office promptly be assigned the task of reviewing postal and private sector pay and benefit levels. Periodical wage and benefit comparability reviews are consistent with all commercial enterprises with which I am acquainted. In my company, we conduct such a review every 2 years.

Another industry best practice is benchmarking the ratio of supervisors to workers and a periodic restructuring and rationaliza-

tion of management and staff levels. In my company, we work actively to reduce headcount per unit output. We do so, often without layoff or dislocation, to minimize personal disruption. With a high number of postal employees soon at retirement age, this is a great time for this type of work.

Another aspect of the Commission's cost control recommendations include network optimization. I urge resisting provisions of law inhibiting the closing of post offices or processing facilities. In the retail trade, it is accepted practice to close and relocate a percentage of stores each year to mirror shifts in population, traffic or shopping patterns.

Businesses also reassess their warehouse and distribution center placement, making changes when costs justify it. It is critical that postal management have the authority to continuously optimize facility utilization and its logistics network free from outside constraints, so that they can place postal services where Americans live, work and shop.

Personal correspondence in the mail is what Americans value most and is among the most profitable. It forms the foundation of what Americans want from their postal service. It used to be common wisdom or commonly held at least that household postage was inelastic. Today, research has shown that the price of single-piece first class stamps does affect demand. If personal mail were to disappear, much of the utility of the postal system for business mailers would disappear with it. We must look beyond volume and recognize the interdependence between mail types. If Americans stop going to their post office, it will kill the system for everyone.

My comments are not criticisms of current postal management; as a matter of fact, quite the contrary. They have been aggressively managing the business and taking strong action indicated by the decline in volume. I both appreciate this and support the moves that they have made. In my judgment, that must continue. But congressional reform will set the ground rules and the tone for future administrations. Without a mandate and the tools to drive increasing advances in its competitive position, the Postal Service will not enjoy the widespread use and brand equity that it has today.

As our high-tech life accelerates, along with the uncertainties of security alerts, military action and the everyday stresses felt by families as they are stretching budgets and meeting obligations, the postal system is a comfort to Americans who consider it a birthright. Each year, over 240 million Americans exchange greeting cards. This week, 1 billion Valentines will be sent. You can send a Valentine to all Americans through the passage of postal reform.

Thank you, Mr. Chairman, for your time. I would be happy to answer any questions you have.

[The prepared statement of Mr. Davison follows:]

Testimony of Hamilton Davison

President and Chief Executive Officer, Paramount Cards Inc.

Before the Special Panel on the U.S. Post Office

Of the Government Reform Committee

Of the U.S. House of Representatives

February 11, 2004

Good afternoon Chairman McHugh and distinguished members of the Special Panel.

My name is Hamilton Davison, President and CEO of Paramount Cards, an industry leader in what we call "value-oriented" marketing. I believe "value-oriented" thinking needs to be imbued into our postal system, supported by this Panel and this Congress. The word "value" is key. In business, a "value-added" approach is the determinant for success, as should be the case with the Postal Service.

I appreciate the opportunity to bring to your attention issues that are vital to the country, my industry and my company. As a former president and current director of the Greeting Card Association, my comments are reflective of the broader perspective of my industry while being anchored in the realities of a competitive marketplace.

Our postal system is in danger and needs a systemic overhaul. As the pace of a high tech life continues to accelerate, along with the uncertainties of homeland security alerts, military action and the everyday stresses felt by families trying to stretch budgets, we find Americans increasingly interested in nostalgic, soft touch means of communicating and commemorating the milestones of those they card about. Because over half of all cards are mailed – as opposed to being hand-delivered by the card giver – the success of the US Postal Service is of paramount concern to us.

Every year, some 240 million Americans exchange greeting cards. This week, on February 14th, more than one billion Valentine cards will be exchanged as Americans express their feelings

to friends and loved ones. This Committee can send a Valentine to America by pumping renewed life into a postal system all citizens rely on.

To succeed in business, you have to listen to customers and adjust to their needs. Several years ago we got the message that consumers thought cards cost too much. We refocused our strategy, creating a retail concept called Cardsmart that offers half priced cards, and doing other thing to get "great cards in peoples' hands at a great price." Nor is Paramount the only company in my industry to respond to demand for lower priced cards. Today, when purchased in quantity, you can buy terrific cards at about 37 cents a piece. We also sell millions of cards each year at 50 cents each when purchased only one at a time. Point here is that Americans demand value in every aspect of the consumer choices they make. The real cost of technology, telecommunications and transportation have all fallen dramatically. Undoubtedly you have seen ads from the largest retailer in the world showing not specific products but some yellow smiley face who keeps on knocking down prices everywhere it goes. Expectations of Americans have been changed. Choices are everywhere. Substitutes are plentiful. Competition is intense.

This same consumer expectation affects the USPS. Common wisdom used to be that the single piece first class, or individual, mailer would pay whatever was charged; household postage was felt to be inelastic. Many argued that bulk mailers should be given the best price at the lowest margin to encourage expansion of units mailed and help finance growth of the network. Today, this is simply not the case. Our research has shown that stamp pricing affects demand and I also have plenty of anecdotal evidence that supports this. One of our Cardsmart store operators, Joe Voelkl, who has 8 stores in upstate New York, related his customer sentiment like this:

"People are put off by the price of postage and it affects the number of cards they send. Even as card prices become more reasonable than a few years ago, the cost of postage has a major impact. This even cuts into our store traffic, which hurts. It's not fair that regular people pay first class rates and our mailboxes are full of bulk mail that somehow gets sweetheart rates."

I agree with Mr. Voelkl. That is the new reality. Point of all of this is that the price of stamps and thus the cost of our postal system is a central element in its viability – in fact its survivability – in the future. Legislation that advocates an efficient, fair postal system would certainly be a great Valentine for Congress to send to the American people … and would be one they enjoy each holiday all year!

For the most part, I agree with the recent Postal Commission's recommendations and the President's Five Principles for Reform. We can tweak elements, but the broad strokes are good. In fact the Greeting Card Association (GCA) was an early advocate for a Postal Commission. The GCA has submitted to you written testimony addressing specific elements we would like to see in any postal reform bill and I agree with the points raised in this testimony. But I hope I have vividly underscored the need for *cost improvement* of the system, not simply caps on further rate increases. The Postal Service must be given the mandate and the tools to drive increasing value in the mail through advances in its competitive position or it will not enjoy the widespread use and tremendous brand equity it has today.

I advocate three important "value-oriented" actions:

- **First… Establish strong and efficient regulatory protection for the captive postal customer, or average Americans**
- **Second… Grant the Postal Service authority to control its workforce and facility costs, just as companies do in all industries**
- **Third… Create a Postal Service business model that recognizes and differentiates the interdependency of first class citizens mail with that of high volume, low cost bulk mail.**

The first point was a cornerstone recommendation of the Presidential Commission on the U.S. Postal Service, which called for a "Postal Regulatory Board" with authority to regulate rates for noncompetitive products and services and subpoena power to ensure financial transparency on the part of the USPS.

The approach taken in the postal reform legislation developed by this Committee's Chairman, John McHugh, and Representative Henry Waxman, also contained this recommendation. A strong Checks and Balances mechanism is vital, including a review of specific rate setting provisions. I'd add a Congressional mandate for both fairness and cost alignment. Mr. Chairman, your leadership in this area is well documented. I am aware also of Congressman Waxman's similar calls as it relates to the health care system. Together, your leadership can nurture the health of U.S. Postal Service. Much like we do not miss good health until it is gone, most Americans won't miss an effective mail system until it is no longer available.

The second point on stringent cost control of workforce and facilities is essential to the long-term success of the Postal Service, just as it is for private sector companies.
This is a major concern for me on two levels. As I stated earlier, controlling costs is an essential element in assuring the long-term viability of the Postal Service. It is also the Commission's *comprehensive* cost control recommendations that make it possible for me to accept a rate setting system that lacks prior review. In fact, I would not have contemplated a post review system before the Commission Report. While the last two years have given me optimism that rates fair to the individual or citizen mailer are considered important by both Postal officials and bulk mailers, when I take a longer view of postal history, I see that this has not always been the case. A strong "Checks and Balances" architecture that survives future Postal administrations is required.

The Commission also raised the issue of wage comparability, which I believe should be resolved. If we are serious about placing the Postal Service on firm financial ground, then this is the seminal question that must be answered before any other workforce changes are contemplated. This matter ties directly to the President's call for Best Practices, Transparency *and* Accountability. I respectfully suggest that the General Accounting Office promptly be assigned the task of reviewing postal and private-sector pay and benefit levels and of making definite findings as to whether postal compensation is comparable. The practice of periodic wage and benefit comparability reviews are consistent with virtually every large commercial enterprise with which I am acquainted. In my company, we conduct such a review every two to three years. Another industry best practice is the periodic benchmarking of the ratio of supervisors to workers and the periodic restructuring and rationalizing of management and staff levels. In my company

we actively work to reduce headcount per unit output, and we do so often without layoff or dislocation, making every possible attempt to minimize the personal disruption these efforts can cause. But we do actively work the cost structure of our supply line because to do otherwise invites falling behind the competition. Nor is this unique to my company. It is reasonable to demand regular annual productivity increases as measured in the real terms of unit cost (and in particular units processed per person). With the high number of Postal employees soon to be at retirement age, a great opportunity is now available to improve the cost structure that we must not let pass.

Another aspect of the Commission's cost control recommendations was achieving an optimum network. I urge resisting provisions of law inhibiting the closing of post offices or processing facilities. In the retail trade, it is accepted practice to aggressively close and relocate some percentage of stores annually to mirror shifts in population, traffic or shopping patterns. Businesses also periodically re-assess their warehouse and distribution center placement and make changes when they are cost justified. The ability to continuously optimize the logistics network and facility utilization and place postal services where America lives, works and shops, free from outside concerns, is critical.

None of my comments in any way are criticisms of the efforts of the current top management team at the Postal Service; quite the contrary. They have been managing the business aggressively, taking strong action indicated by the current crisis in volume – all moves I support and appreciate. My judgment is that this must continue. Congressional reform, however, will set the ground rules for future administrations.

Regarding other Presidential Commission recommendations, I concur that:

- **Collective bargaining should be improved.**
- **Benefits such as pension and health care plans should be included in negotiations for future employees and retirees.**
- **The USPS should be granted relief from the Federal Employee's Compensation Act to make changes set forth by the Commission and bring Worker's Compensation claims into line... and**
- **A statutory salary cap should be repealed to attract and retain officers and employees with pay competitive with the private sector.**

All of these are consistent with private sector best practices.

As to my third major recommendation, my industry has advocated 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. 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. We must look beyond volume and recognize the interdependence between mail types. If Americans stop going to their mailboxes it will kill the

system for everyone. In fact, even a rate cap pegged to inflation represents a concession from my standpoint. Gains in productivity should also be reflected in any rate cap mechanism.

Mr. Chairman, let me underscore that I believe these steps are essential. It would be difficult, if not impossible for me to support any postal reform legislation that fails to allow the Postal Service to manage its costs effectively.

In summary, let me reiterate my commitment to ensuring the viability of the Postal Service into the future. It is a commitment to preserve the communication network that binds our nation together through universal service at affordable rates. I believe a strong and effective regulatory system, providing the necessary checks and balances, coupled with effective cost controls and a business model that looks beyond mere volume are the most important components to achieving that goal.

Thank you Mr. Chairman for your time. I would be happy to answer any questions you or your colleagues may have.

Mr. MCHUGH. Thank you, Mr. Davison.

Next, Ms. Rebecca Jewett, who is president and chief executive officer of Norm Thompson Outfitters, Inc., the great catalog company. We are thrilled that you are here today, ma'am.

Ms. JEWETT. Thank you very much. And thank you so much for inviting me to be here today.

My name is Rebecca Jewett and as of 2 weeks ago I am honored to have a new role at Norm Thompson. I am now vice chairman of Norm Thompson Outfitters. Norm Thompson is a catalog company. It was formed 54 years ago in Portland, OR. We are a mid-tier catalog company, certainly nowhere near the size of our colleagues on the former panel. We employ 600 full-time and 2,000 seasonal employees. We sell merchandise to upscale customers throughout the United States.

A week ago, I asked our accounting department to rank our vendors based on the amount of money we spend with them. You would be interested to know that our largest vendor is the USPS. In fact, we spend with the USPS four times the amount that we do with our No. 2 vendor. Postage represents 50 percent of our marketing costs. So needless to say, our employees depend on the USPS. I like to think as the USPS goes, so goes Norm Thompson.

In addition, companies who depend on an affordable postal system employ, as we heard earlier, 9 million people, and contribute $900 billion to our economy. No business can survive on a 34 year-old business model. Certainly, the catalog business has changed significantly since I entered it in 1981. It is amazing that the USPS can still operate on its model from the 1970's. The USPS is a cornerstone of our democracy, because we must be able to communicate on a personal and business level with every citizen. That is one of the needs of a democracy.

The USPS is also a major contributor to our economy and it is a creator of jobs. Now, we have the best democracy in the world and we have the largest economy. We deserve to have a world-class postal system to provide infrastructure to support democracy, the economy and job creation. I want to thank each of you for your work on this issue. It is important and foundational for all Americans. We support reform.

Now I would like to discuss how postal rate increases affect my company. We need the USPS to have flexibility to set rates. I have run catalog companies since 1990. I can tell you how earth-shattering double-digit rate increases were to catalogers in the 1990's. In fact, we wondered if we would survive. We survived for four reasons. First, the printers innovated and removed significant costs from their structure and passed those savings on to us as customers. This helped mitigate postal rate increases. Second, the paper market softened and we found we could purchase paper for less. This also helped mitigate postal rate increases. We as mailers knew that we had to do business differently. So as a mailing community, we became much more sophisticated in how we deploy our marketing dollars. This also created cost efficiencies and helped mitigate the postal rate increases. Last, the USPS was able to contain costs and implement worksharing, which has stabilized rates in the early 2000's, and we thank them for that because it has been very helpful.

The USPS has done a good job so far, but we need Congress to empower the USPS to build a new business model to provide a world-class infrastructure. As mailers, we need stability and predictability for postal rates and rate increases to be held at or below inflation.

Let me tell you about the impact of increases above inflation, what impact they would have on our company, if there were an increase 10 points above the inflation rate, what we would do. The low-hanging fruit has already been taken. So we would have to cut circulation in ways that would be fundamentally detrimental to both the USPS and to Norm Thompson. What we would do is we would cut our prospecting circulation in the months between January and September. We would not cut circulation during the profitable holiday season, which is I believe the peak volume season for the USPS, and when they would actually probably prefer us to cut volume. We would be cutting volume in the low-volume months when the USPS has excess capacity. This would be very detrimental to the USPS.

Cutting the circulation has a negative impact on my company also. We would have to cut labor to match the reduced demand, and who would we cut? Well, we would cut wonderful full-time associates who have health benefits. We would not be cutting our seasonal part-timers, who do not have health benefits. We would be cutting associates in our customer phone center in Oregon where there is 7 percent unemployment. It is one of the highest unemployment rates in the country. As a country, I would like to say we have lost a lot of telemarketing jobs to India in the past couple of years. Wouldn't it be an enormous disappointment if a postal rate increase contributed to the loss of jobs in this important sector? We would also have to cut full-time associates who are also covered by health benefits from our West Virginia distribution center. The State of West Virginia has done a magnificent job over the past 10 or 15 years creating new jobs in that State. I would also like to say that as a country, we have lost many manufacturing and warehousing jobs to overseas production. Again, wouldn't it be an enormous disappointment if postage rate increases contributed to more job losses in this sector also?

So how many jobs are we talking about? Well, in the greater scheme of things, after all, we are a relatively small company, not much, maybe 20 jobs. But it is significant to the person who is losing their job that they have lost it. But also I want you to consider that there are 2,000 catalog companies in this country, and 20 jobs across 2,000 catalog companies is a significant number of employees, about 40,000. With a 15 percent increase, it would be another 50 percent, these 60,000 jobs lost. This does not include the ripple effect on our vendors.

So raising rates above inflation to solve the USPS financial problem does not work. We need Congress to empower the USPS to build a new business model so that it can provide world-class infrastructure to support our democracy, our economy and our jobs. So how will they do this? I leave answering this question to others and my written testimony on the how.

I would like to speak just briefly about universal service. Norm Thompson needs universal service. It is what the USPS does best.

That last mile is very critical to us. Universal service for all catalogers includes package delivery. We use USPS for a majority of our product delivery. But even fellow catalogers who use other package delivery companies know that USPS provides competition which holds down costs for all.

So I want to thank you for your important work. You will have a major impact on preserving what is best about our democracy, our economy and our jobs. All of us from Norm Thompson want to thank you for the important work that you are doing.

[The prepared statement of Ms. Jewett follows:]

Testimony of Rebecca Jewett
On behalf of Norm Thompson Outfitters, Inc.
Before the Committee on Government Reform,
United States House of Representatives

February 11, 2004

Chairman Davis, Representative Waxman, Task Force Chairman McHugh and Representative Davis, and members of the Task Force, I am Rebecca Jewett, and I thank you for inviting me to testify before you today on the importance of a viable U.S. Postal Service. Since I received your invitation to testify, I became Vice Chairman of Norm Thompson Outfitters, Inc.

Norm Thompson is a leading catalog direct marketing company founded in Portland, Oregon in 1949. Fifty years ago we were selling hand-tied fishing flies to discerning fishermen. Today, we are more apt to be found selling handknit sweaters to our discerning customers. Nevertheless, now as then, Norm Thompson depends on the U.S. Postal Service as its primary marketing channel to reach current and prospective customers. Without the mail, there would be no Norm Thompson, Inc. The Postal Service is our biggest and our most important vendor – we spend more money with the Postal Service than with any other single vendor we use.

It is this reliance on or, if you will, partnership with the Postal Service and my concern over its future and ultimately its impact on Norm Thompson, our 600 full time associates and 2000 seasonal employees and the many others in our supply chain that brings me here today. Postal reform is not just about the U.S. Postal Service. It is about jobs and the economy throughout our Nation.

Fourteen months ago--on December 11, 2002--that President Bush issued an Executive Order establishing the President's Commission on the United States Postal Service. The Commission was directed to look at the state of affairs and was charged with the responsibility of articulating a vision for the future of the Postal Service.

The Commission found that the most significant obstacle to the Service's survival is its "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."

To those of us who have followed the plight of the Postal Service, that the Commission would reach this conclusion is no surprise. We are, after all, dealing with an entity whose foundation is a 34 year-old business and regulatory model, which 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. It is an important statement, nevertheless, because it comes from nine fresh sets of eyes--from individuals with considerable business experience but who in their professional capacity are not postal stakeholders.

Given my own business experience, I simply cannot imagine being restricted to operating in the same way as did my predecessors of some thirty years. Moreover, in my capacity as Chairman of the Board of Directors of the 4700-member Direct Marketing Association, I can say with some degree of confidence that my fellow business executives agree completely with the Commission's assessment.

Your invitation to appear today asked that we speak to the five guiding principles the White House outlined in its call for comprehensive postal reform. The five principles--application of best practices, transparency, flexibility, accountability and self-financing--were distilled from the thirty-five recommendations contained in the Commission's final report. These recommendations, roughly half of which could theoretically be implemented within the confines of existing law, present a road map that builds—and wisely, I might add-- on the past efforts of this Committee and the Postal Service's Transformation Plan.

While one might quibble over the details of a particular Commission recommendation or wording of a White House principle, their collective thrust makes good sense.

Although I will direct much of my testimony to the importance of the need for flexibility, this is not meant to diminish the importance of the others principles. One need only consider the extent to which the Postal Service's revenue base could be eroded by a rapidly changing communications landscape to appreciate the importance of consideration being given of each and every principle and recommendation in developing a new business model for the Postal Service.

Clearly, little, if any, of what has transpired in the last decade alone could possibly have been foreseen by the architects of the Postal Reorganization Act of 1970. Moreover, it is unlikely that they envisioned a time when the realities of a declining volume base, characterized as "sobering and credible" by the President's Commission, would be required to support an ever-growing delivery network--a situation which is economically unsustainable.

When he testified before the Senate Government Affairs Committee last fall, Jim Johnson, Vice-Chair of the President's Commission, was asked for an assessment of how long he thought we could go with the current system before reaching the crisis stage. His response, I thought, was very insightful.

He offered that the Postal Service's financial situation is somewhat better today than it was two years ago due largely to (1) action by the Congress to correct the formula for funding the retirement of postal employees and (2) the successes of the Postmaster General and his management team in containing costs and increasing efficiency. I would be remiss at this point if I did not recognize and express my appreciation for what you—the Congress--have done and for the efforts of the PMG. But as Mr. Johnson noted, the reality and the challenges of two years ago are still with us; that we have not a long time to get it straight (but have time to get it right).

If we do not move ahead expeditiously with significant modernization, the choices outlined by the commission will be dramatic service rollbacks, rate increases of an unprecedented scale, or falling further into debt, ultimately requiring a taxpayer bailout. Each of these three options is equally unacceptable for Norm Thompson, for me as a taxpayer and for a system that today supports a segment of our economy that accounts for approximately 9 percent of GDP — some $900 billion — and supports the employment on the order of 9 million Americans. Consequently, 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 would limit available options for the future.

As you move forward in crafting postal reform legislation, I urge to consider that reforms must be couched in a dynamic context with the recognition that managers need the flexibility both to meet the ever-changing demands of the marketplace and to manage their infrastructure and their workforce.

I. FLEXIBILITY TO SET RATES

While the existing rate setting scheme may have been tolerable in an early era, the length of time, complexity and cost involved in litigating rate cases now results in diminishing returns for both the Postal Service and its customers. The Postal Service, as does any business, needs pricing flexibility to meet the demands of the market.

In addition to reasonable degree of flexibility to adjust rates, generally, the new business model for the Postal Service should authorize customized service and rate agreements (also known as negotiated service agreements) that offer an economical benefit to the overall system as well as to the parties to any such agreement. Other players in the marketplace have this ability and use it.

But just as the Postal Service needs flexibility, so do mailers need a semblance of predictability. Thus, separate and apart from the manner in which specific rates are developed, the magnitude and timing of rate changes are critical considerations in terms ensuring overall economic efficiency.

Those of us in the direct mail catalog business—and we are not alone in this regard—are having increasing difficulty accommodating rate increases that far exceed the general rate of inflation; in our case, averaging on the order of 22% over the past 5 years while the rate of inflation for the period was in the 14% range. We have reached the point where, in many cases, the cost of mailing a catalog equals or may even exceed the cost of producing that catalog. This situation is counterproductive for the mailer and the Postal Service.

Recognizing that there may be exigent circumstances, I believe that any pricing flexibility granted the Postal Service must be tempered with a degree of systematic discipline. As a general principle, rate adjustments should, as nearly as is practicable,

mirror the lesser of the rate of inflation as measured by the CPI or the actual cost of providing services and should occur no more frequently than once a year. Moreover, as an incentive to hold down rates, postal management should be able to avoid lengthy before-the-fact rate regulation *IF and ONLY IF* rates are held *BELOW* inflation.

II. FLEXIBILITY TO ADJUST THE NETWORK OF FACILITIES

The Postal Service's 25-year experiment with worksharing in the transportation and processing of mail provides ample evidence of wide-ranging benefits to itself, all users of the system and the economy, generally. Unbundling the various elements of the process, has promoted economic efficiency. According to the General Accounting Office, nearly three quarters of all domestic mail is workshared enabling the Postal Service to realize billions of dollars in savings. The continued unbundling of all functions upstream from the ultimate delivery of the mail should be a paramount objective for the "new" Postal Service in order to optimize efficiency and constrain costs.

Implicit in capturing the full economic benefit of unbundling is that the Service be vested with adequate authority to right-size its upstream "legacy" infrastructure. The Service cannot survive if there are constraints placed upon its ability to establish and constantly adjust an effective and economical processing, transportation and delivery network. In this regard, a mechanism that insulates network changes from the political process, while at the same time accommodating the need for postal management to make ongoing adjustments, would appear to be in order.

III. WORKFORCE FLEXIBILTY

Increased worksharing and rightsizing of its network will mean a smaller internal workforce. However, network changes need not precipitate draconian changes for the dedicated Postal Service workforce. With nearly one half of career employees eligible for retirement by decade's end, this presents an opportunity to couple network changes and workforce attrition.

Management and employee groups should use the bargaining and consultation processes explore the liberalization of work rules as a means of mitigating the impact of network realignment. Requiring the Postal Service to develop a comprehensive human resources plan would seem to be in order as a precursor to this effort.

Modest adjustments to the current collective bargaining process, such a requiring mediation and restricting arbitration awards to be prospective, only, may also be in order. I would envision these changes resulting in a greater range of options and incentives for both management and employees, without significantly diminishing the rights of employees. And, while I support fair and full collective bargaining, an addition to existing the law should require arbitrators to give weight to the changing nature of the communications landscape, and the importance of achieving productivity gains as a means of ensuring the viability of the postal system.

IV. UNIVERSAL SERVICE

With some limited exceptions, the U.S. Postal Service delivers to everyone, everywhere six days a week. Providing this universal service its distinguishing hallmark. I support its continuation. Service to the American public and their businesses should not be a victim of any type of postal reform. As an aside, universal service should include parcel delivery. Package services are and always have been a core service offering of the Postal Service. At Norm Thompson we use the Postal Service to deliver a significant proportion of our products to customers, and we need that service. In addition, we know that Postal Service parcel delivery represents competition, which holds down parcel delivery costs for all.

However, as the Presidential Commission noted while universal service and the postal monopoly--as currently perceived--are vital to the Nation and its economy, this may not always be the case. The Commission suggested that a review of this status over time would be appropriate, necessary and possible, without sacrificing affordable access to essential services. I agree with this idea in principle. Having so stated, I believe Congress must retain some degree of authority over this matter, which is clearly of policy in nature.

V. SELF-FINANCING

On the matter of self-financing, I take no issue with the Administration's position that the Postal Service be self sufficient, covering all of its obligations. I, however, question whether certain obligations should be assigned to the Postal Service.

For example, while almost all of the Presidential Commission's recommendations address the necessity of updating the antiquated laws governing the Postal Service, one recommendation proposes a change to the Postal Civil Service Retirement System (CSRS) Funding Reform Act (Public Law 108-18) enacted just last year.

The 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—much of which predates even the 1970 postal law--should be borne by taxpayers, not ratepayers, as is the case for all other federal government entities. I concur fully with this recommendation. Paying for the military and all its subsequent obligations is, in part, my responsibility as a taxpayer not as a mailer. Moreover, the $27 billion obligation includes a $17 billion return to the Treasury for payments already made. At least, mailers should not be responsible to reimburse the government for past payments to retirees.

Another aspect of the 2003 CSRS law requires the Postal Service to build into future rate cases amounts no longer required to fully fund employee retirement and to place those funds in an escrow account pending Congressional approval of a disbursement plan. It would be more than just unfortunate if the billions of dollars at issue where extracted from the economy only to become a pawn in the arcane intricacies of the government budget. Congress must act to eliminate the escrow requirement this session to avoid adding to the next postal rate increase. Mailers should not be charged based upon the old over-funding CSRS formula—the current escrow law would force that sad occurrence.

SUMMARY

In closing, I want to endorse 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, I agree with the Commission's view that "an incremental approach to Postal Service reform will yield too little too late...." Therefore, I urge you to adopt a comprehensive approach to postal reform, including appropriate changes to the retirement the legislation to further ensure the Service's financial stability.

Mr. MCHUGH. I thank you, Ms. Jewett.

I apologize we have to run. We have two quick votes. Mr. Mulloy, it is like icing the field goal kicker, but we will give you a new chance. We will return as quickly as we can. Please stand in recess until we return.

[Recess.]

Mr. SCHROCK [assuming Chair]. I apologize for this seemingly disorganized day, but the fact is that is what it is. I was talking to one of my colleagues here on the way over, and I said, "You know, if these guys did business like we do this, they would all have been bankrupt decades ago." So we need to use you as role models. Mr. Mulloy, you have the patience of Job and I really do appreciate that. We are glad you are here and we look forward to your testimony.

Mr. MULLOY. Thank you.

Mr. SCHROCK. Excuse me, before that. Ms. Jewett had to catch a plane, and so the panel will submit questions to her in writing, just so nobody will think we drove her off. Thank you.

Mr. MULLOY. Thank you, Mr. Schrock. As you said, my name is Gary Mulloy and I am chairman and CEO of ADVO. ADVO is the largest in-home print advertising company in the United States. We touch 8 out of 10 American households weekly or monthly. I am pleased to be here on behalf of our 3,700 associates and all of the associates of the 20,000 clients large and small across America that rely upon us to deliver their advertising messages via, predominantly, the U.S. mail.

I have submitted extensive written testimony. I am not going to belabor a lot of what is in those materials. I am going to focus on several issues today. However, as you have heard from most of the panelists, both on the first panel as well as this panel, I would echo that we believe that there is a tremendous amount of growth potential in the mail. The Postal Service, if properly focused, can in fact prosper and benefit from that growth.

Unfortunately, for the last 15 years postal rates have been higher than I believe truly necessary to fund the operations of the Postal Service. The result has been that less than competitive pricing has led existing and potential customers elsewhere. It has also led to the creation of competitive alternatives, some of which have been created by people like ourselves who have been forced to look at private carrier delivery and other sources because of the fear of rising postal costs, which in some cases are twice that of running your own private carrier delivery system. In fact, we have personal experiences just like the one another panelist talked about, Ann Moore. We do run our own private carrier delivery service in several large markets, and the costs are substantially less.

We believe that all in private industry would use the USPS more and both the Postal Service and industry would experience growth if prices and rates were established and maintained in a more market-oriented efficiently run system. Our current strategy for our own company calls for us to double our business over the next few years, but much of that growth will of necessity be outside of the postal system unless changes are made.

The potential market is big enough to pay for universal service, and universal service is, we believe, 6 day-a-week delivery to every

household in America. It is big enough to end discussion, we believe, about 5-day delivery and get the Postal Service thinking about the opportunities presented by 7-day mail delivery instead. It is even big enough to relieve pressure on some of the traditional features of the Postal Service that the American public has long enjoyed, such as post offices in the smallest communities in the country.

To tap into this, though, we have to have competitive prices. We believe such an extended period of stability is not only desirable, but reasonable and achievable. Stable rates are not a pipe dream. Since 1971, the Postal Service has been required, as you know, to break even and to charge mailers its cost of operations. Contrary to popular perceptions, however, and to media misrepresentations, the U.S. Postal Service has not been chronically losing money or breaking even in its operations. In fact, since it was created, the Postal Service has generated an operating profit, and a handsome one.

Since 1971, postal revenues have been billions of dollars more than the cost to fund operations of the U.S. Postal Service. Even if Congress were to force the Postal Service to book all 100 percent of its health care liability for retirees today, the Postal Service would still have generated billions more in excess revenue through rates charged mailers and consumers and the rates that are still in place today.

This money has gone to the U.S. Federal Treasury. The USPS is not subsidized by the taxpayer. It has surprisingly been subsidizing the taxpayer. Last year, this committee took the first steps to correct the retirement overpayments made by the U.S. Postal Service to the U.S. Treasury. This was an important first step, but it is only a partial and temporary solution, and included some provisions that, as we have discussed earlier today, are not in the long-term best interests of the Postal Service, the consumer or the economy at large.

Part of last year's fix required the Postal Service to pay military, Peace Corps and other government retiree benefits. This action transferred $28 billion in additional obligations to ratepayers. These costs are not rightly the responsibility of the Postal Service and its customers and consumers. Unlike other Federal agencies, the U.S. Postal Service does not receive Federal appropriations, but must charge for the services it provides. The cost of military service time for most Federal agencies is paid for by the general treasury, and thus taxpayers as a whole. Singling out postal ratepayers to cover this obligation that benefits all taxpayers is thus unfair.

Customers are able to cover the costs of Postal Service operations through the rates they pay. However, adding additional expenses such as retirement benefits earned as a result of military service pushes postal rates up to uncompetitive levels. The President's Commission recommendation to undo last year's damage must be taken care of immediately, we think, by this body. All of the customers of the Postal Service, with the exception of nonprofit mailers, are also taxpayers and our taxes fund these and other programs. To be required to pay for them again through higher postage rates is a form of double taxation.

Also, in implementing last year's fix to the CSRS overfunding, the OPM also quietly made a very large accounting change with regard to allocating the responsibility to pay for pensions earned as a result of work performed by postal employees prior to 1971. The 1970 Postal Reorganization Act made the Treasury responsible for employee benefits earned while working for the old Post Office Department, and it made the Postal Service responsible for benefits earned after it took over.

For years, the benefit obligation for retirees with employment both before and after 1971 was allocated between the Postal Service and the Treasury, based on the number of years of service employed at each agency, allocating the same dollar amount to each year of employee service. Last year, when the factual actuarial error regarding CSRS funding was corrected, the Office of Personnel Management quietly switched to a new allocation method that effectively shifted a large portion of the pre-1971 obligation to the Postal Service to the detriment of the Postal Service and therefore its customers and the consumer.

While there can be legitimate disagreement about the proper method for making judgments about allocation of benefit obligations, the factual actuarial error is not open to judgment or opinion. The allocation method used for 32 years was fair and was recently determined to be consistent with common practice by Hay Associates, an actuarial firm commissioned by the Postal Service. Changing it now shifts pre-1971 Treasury obligations to the Postal Service and its ratepayers as a sort of penalty for finally correcting the factual actuarial errors that have been allowed to stand for years.

The difference between the old allocation method, which had been in place for years, and the new method imposed by OPM, changes the Postal Service's balance sheet by tens of billions of dollars, far more than enough to fully fund both CSRS and retiree health benefit liabilities. This is an unfair burden that today's Postal Service and its consumers and customers should not have to bear. Additionally, the legislation passed last year required for 2006 and beyond that the Postal Service must resume making overpayments to the CSRS system in the form of escrow payments. As you have heard from other people today, we believe that this should be struck down. Because these funds are from Postal Service customers and consumers, they could be more properly used to be invested in better productivity and efficiencies within the Postal Service, and therefore those benefits would provide an overall stimulus for the U.S. economy.

This committee can take steps toward righting these wrongs and put the Postal Service back on track to growth with better, expanding service. Congress can and should take strong action to clean up the misallocation of billions of dollars in paid-in retirement dollars by the USPS by first, returning the allocation methodology for retirement benefits earned by USPS workers before 1971 to the method utilized prior to last year and that method used by the vast majority of pension fund calculations, whether that be for private sector or public sector. The USPS has appealed to the Board of Actuaries as provided for in last year's legislation, but there is no need for Congress to await the result of that appeal to apply this

commonsense solution and eliminate the effects of this arbitrary punitive action. Second transferring responsibility for military and other government service benefits back to the general treasury recognizes that the Postal Service is unlike other Federal agencies that receive Federal appropriations. Once relieved of both of these unfair burdens, the Postal Service will be able to fully fund its CSRS and its health benefits liability. Finally, the Congress should repeal the escrow provision of last year's law through at least 2008 and allow the true profitability of the operations of the Postal Service to be utilized to invest in productivity and efficiency improvements, and generate the economic stimulus of rate stability for this critical component of the U.S. economy.

According to some of the most respected economists studying the industry, if all of these things were addressed in a comprehensive way at a single time, with the help of other meaningful reforms that this body can enact to control costs and grow the business of the Postal Service, that Service should be able to fund its retiree health care obligation in total, eliminate debt, and freeze rates for years beyond the requirement of the current law, at least through 2008 and probably beyond.

With the retirement funding issues addressed, the principles for postal reform articulated by the administration will succeed. In particular, I would note the urgency of applying the principles of best practices and flexibility to the areas of pricing and costs. The Postal Service needs to be able to respond to its marketplace and, as the Presidential Commission recommends, be given greater ability to enter into contracts with its customers large and small. The Postal Service must also be given the tool to control costs and manage its resources.

These steps will allow the Postal Service to build substantial volume that covers its costs and contributes properly to overhead at a time that the Service will be undergoing major systematic changes that you are championing. I would again call your attention to the written materials that I have submitted, which go into greater detail on these and other issues.

The stakes for the American consumer, our economy and the business users of the U.S. Postal Service could not be higher. I think you have heard from every other member of both of these panels that in various industries and various constituencies, this is very important to us. The time is now, and we urge you to act expeditiously.

Thank you very much.

[The prepared statement of Mr. Mulloy follows:]

TESTIMONY OF

Gary M. Mulloy
Chairman and Chief Executive Officer
ADVO, Inc.

To the

Special Panel on Postal Reform and Oversight

February 11, 2004

Mr. Chairman, Representative Davis, Members of the Committee:

My name is Gary Mulloy. I am Chairman and CEO of ADVO, Inc., the largest in-home print advertising company in the United States. We touch eight out of ten American households weekly or monthly and are the Postal Service's largest user of standard mail. I am pleased to represent the 3,700 ADVO associates that service over 20,000 of the nation's small and large businesses. They and the shareholders of our NYSE-listed company are counting on the wisdom and leadership of this body and so are the employees, customers and owners of all the businesses we serve who rely upon the services of the United States Postal Service to strengthen their individual businesses and the U.S. economy. I am also pleased to speak on behalf of saturation mailers more generally. Collectively we mail 15.2 billion advertising pieces and packages through the Postal Service each year. The Postal Service would not be viable without this volume and the revenue it generates.

ADVO is proud to have worked with many of you on this committee, particularly Representatives McHugh of New York and Davis of Illinois, as you have struggled to implement positive change that would modernize the Postal Service while protecting this national asset entrusted with the important policy objective of universal service to ensure that the citizens of our country have access to this important communications network.

I have submitted extensive written testimony for the record, intended to help as you consider legislation to ensure that the Postal Service will be able to effectively compete in the market and efficiently meet the nation's needs well into this new century. My written submissions cover a range of issues from the price-setting mechanisms and process to cost management measures the Postal Service should take. Once needed reforms are made, I am optimistic that the Postal Service can continue to serve the citizens and businesses of our nation and can play an important role in fostering future economic growth for our country. My brief remarks today, however, are intended to call your attention to a few of the key issues detailed in those documents.

For at least the past 15 years, postal rates have been higher than truly necessary to fund the operations of the Postal Service. The result has been non-competitive pricing which has led existing and potential customers elsewhere. It has also led to the creation of competitive alternatives that have drained revenue and profits from the Postal Service. Some, like us, have even begun private delivery alternatives as a necessary hedge against rising postal costs which in some cases are nearly twice that of a private delivery system.

We believe that all of us in private industry would use the USPS more, and both the Postal Service and industry would experience significant growth if prices and rates were established and maintained in a more market-oriented, efficiently run system.

ADVO estimates that a hypothetically restructured USPS could offer prices that would enable us to seek to triple our business to a $3 billion dollar organization. Other saturation mailers could see similar growth opportunities. Our current strategy calls for us to double our business over the next few years, but much of that growth will, of necessity, be outside the Postal Service unless changes are made. Our growth will come from both the largest companies in our country as well as from the very smallest businesses. Small businesses in particular look to the mail to provide otherwise unaffordable advertising that reaches their lifeblood — the local customer.

The shame is that mail *can* be delivered at a price that would give these small businesses the vehicle they need to compete. The potential market is big enough to pay for universal service for a long time to come. It is big enough to end discussion about five-day delivery and get the Postal Service thinking about the opportunities presented by seven-day mail delivery instead. It is even big enough to relieve pressure on some of the traditional features of the Postal Service that the American public has long enjoyed, such as Post Offices in some of the smallest communities in our country.

To tap into this potential market, the Postal Service must be able to offer competitive prices. A necessary step is to continue the current period of rate stability beyond the

2006 date that has been promised as a result legislation supported by the members of this committee on the CSRS issue. The volume generated by this hiatus in rate increases, coupled with the impact of the adoption of the important reforms under consideration by this committee, would set the Postal Service on a positive course for the next generation. A major element of this positive course would be for the Postal Service to keep rates at current levels at least through 2008, and we believe such a period of rate stability is not only desirable but also reasonable and achievable.

Stable rates are not a pipe dream. This committee can lead the Congress to make them a reality. Since 1971 the Postal Service has been required, as you know, to break even by charging mailers its cost of operation. Contrary to general perceptions and media misrepresentations, the USPS has not been chronically losing money or breaking even in its operations. In fact, since it was created, the Postal Service has generated an operating profit, and a handsome one at that.

That's right.

Since 1971, postal revenues have been billions of dollars more than the cost to fund the operations of the USPS. Even if Congress were to force the Postal Service to book 100 percent of its health care liability for retirees today, the Postal Service still would have generated billions more in excess revenue through rates charged mailers in the past and still in place today.

Where has that money gone? To the Federal Treasury.

That's right. The USPS is not only NOT subsidized by the taxpayer; instead, surprisingly, it has been subsidizing the taxpayer.

Last year this committee took the first steps to correct the retirement overpayments made by the USPS to the U.S. Treasury. This important first step was only a partial, temporary solution and included some provisions that are not in the long term best interests of the Postal Service, its customers, or the economy.

Part of last year's legislative "fix" of CSRS required the Postal Service to pay military, Peace Corps and other government retiree benefits. This action transferred $28 billion in additional obligations to ratepayers. These costs are not rightly the responsibility of the Postal Service and its consumers and customers. Unlike other federal agencies, the USPS does not receive federal appropriations but must charge its consumers and customers for the services it provides. The cost of military service time for most federal agencies is paid for by the general treasury, and thus taxpayers as a whole. Singling out postal ratepayers to cover this obligation that benefits all taxpayers is thus unfair. Customers are able to cover the costs of Postal Service operations through the rates we pay. However, adding additional expenses, such as retirement benefits earned as the result of military service, pushes postal rates up to uncompetitive levels, drives business to seek alternatives, and undermines the financial viability of the Postal Service itself. The Presidential Commission's recommendation to undo last year's damage by removing responsibility

for military pensions from Postal Service customers should be immediately acted upon by this body. The USPS and its customers have no more business paying military retirement benefits than paying for missiles, or traffic lights or public housing. Of course all of the customers of the Postal Service (with the exception of nonprofit mailers) are also taxpayers, and our taxes fund these and other programs. To be required to pay for them again through higher postage rates is a form of double-taxation.

In implementing last year's fix to the CSRS over-funding, the OPM made an accounting change with regard to allocating the responsibility to pay for pensions earned as a result of work performed by postal employees prior to 1971. The 1970 Postal Reform Act made the Treasury responsible for employee benefits while working for the old Post Office Department and it made the Postal Service responsible for benefits earned after it took over. For years, the benefit obligation for retirees with employment both before and after 1971 was allocated between the Postal Service and the Treasury based on the number of years of service employed at each agency, allocating the same dollar amount to each year of employee service. Last year, when the factual actuarial error regarding CSRS funding was corrected, the Office of Personnel Management quietly switched to a new allocation method that effectively shifted a large portion of the pre-1971 obligation to the Postal Service to the detriment of Postal Service and therefore its consumers and customers. While there can be legitimate disagreement about the proper method for making judgements about allocating the benefit obligation, the factual actuarial error is not open to judgement and opinion. The allocation method used for 32 years was fair and was recently determined to be consistent with common practice by an actuarial firm

commissioned by the Postal Service. Changing it now shifts pre-1971 Treasury obligations to the Postal Service and its ratepayers as a sort of penalty for finally correcting factual actuarial errors that had been allowed to stand for years. The difference between the old allocation method, which had been in place for years, and the new method, imposed by OPM, changes the Postal Service's balance sheet by tens of billions of dollars – far more than enough to fully fund both CSRS and retiree health benefits liabilities. This is an unfair burden that today's Postal Service and its consumers and customers should not have to bear.

Additionally, the legislation passed last year required that, for 2006 and beyond, the Postal Service must resume making overpayments to the CSRS system (in the form of escrow payments) until Congress is satisfied with the Postal Service's plans. Because these funds are from Postal Service consumers and customers — us — they should be used to their — meaning our — benefit. Those benefits include operational efficiencies and productivity improvements while rate stability and volume growth are maintained. In other words, those benefits would provide an overall stimulus for the U.S. economy.

This Committee can take steps toward righting these wrongs and put the Postal Service back on track to growth with better, expanding service. Congress can and should take strong action to clean up the misallocation of billions of dollars in paid-in retirement dollars by the USPS by:

First, returning the allocation methodology for retirement benefits earned by USPS workers before 1971 to the method utilized prior to last year. The USPS has appealed to the Board of Actuaries, as provided for in last year's legislation, but there is no need for Congress to await the result of that appeal to apply this common sense solution and eliminate the effects of this arbitrary punitive action.

Second, by transferring responsibility for military and other government service benefits back to the general Treasury to recognize that the Postal Service is unlike other federal agencies that receive federal appropriations.

Once relieved of both of these unfair burdens the Postal Service will be able to fully fund its CSRS and retiree health benefits liability.

Finally, the Congress should repeal the escrow provision of last year's law (Public Act 108-18) through at least 2008 and allow the true profitability of the operations of the Postal Service to be utilized to invest in productivity and efficiency improvements and generate the economic stimulus of rate stability for this critical component of the U.S. economy.

According to some of the most respected economists studying the postal industry, if all of these retirement issues are addressed in a comprehensive way, with the help of other meaningful reforms to control costs and grow the business, the Postal Service will be able

to fund its retiree health care obligation, eliminate debt, and freeze rates for years beyond the requirement of the current law — at least through 2008 and possibly beyond.

With the retirement funding issues addressed, the principles for postal reform articulated by the administration will succeed. In particular, I would note the urgency of applying the principles of best practices and flexibility to the areas of pricing and costs. The Postal Service needs to be able to respond to the marketplace and, as the Presidential Commission recommends, be given greater ability to enter into contracts with its customers, large and small. The Postal Service must also be given the tools to control costs and manage its resources. These steps will allow the Postal Service to build substantial volume that covers its costs and contributes properly to overhead at a time that the service will be undergoing major systematic changes that you are championing. I would again call your attention to the written materials I have submitted to the Committee which goes into greater detail on these and other issues.

The stakes for our economy and the business users of the USPS could not be higher. Without prudent action by this Committee and Congress, there is no question that the USPS will eventually crumble under the weight of non-market pricing that subsidizes general treasury functions. The fate of our employees, our customers, the employees of our customers, and our collective shareholders hang in the balance of your deliberations.

Thank you for your attention today and for the time and energies you have already spent on our behalf.

Mr. SCHROCK. Thank you, Mr. Mulloy. As I listened to you speak, I understand your arguments for pension reform and why you believe they have been overcharged. I also understand why an extended rate freeze would be good for mailers. How would all that be good for the Postal Service?

Mr. MULLOY. I really believe that, as you have heard many people on the panel say, a normal amount of price increase is to be expected in relation to inflation is in fact the wrong way to approach a business. I think it is important that mailers and the consumer look at the mail channel as having pricing stability and in fact use price to encourage the kind of behaviors that are going to drive greater efficiencies and productivities to better prolong the life of the U.S. Postal Service. It is a vital part of the communications fabric of our country and the business fabric of our country. We think that prolonging that and extending the life of it and making it an even more vital part of our economy is critical.

Mr. SCHROCK. Mr. Davison.

Mr. DAVISON. Congressman, we heard from our customers loud and clear that they felt the price of our products were too high. We completely changed our strategy. We completely reinvented our supply chain and changed everything about our company, including launching a retail concept where we offer regularly half-price cards every day. We have been rewarded with increased volume, increased demand, increased consumer traffic. There is a factor of elasticity of demand in many things. I suspect strongly and have actually read some research that confirms that the amount of consumer mailing, at least, is strongly dependent on the price paid at certain times of the year, in particular holiday card times where there are multiple sending situations.

So I think there is a case to be made in a variety of industries, certainly within a variety of mail segments, that getting some cost control and efficiency improvements will actually improve the amount of mailing. It does not have to be a zero-sum game. That does not mean that you pay people less. It just means that you improve the system to get more out of it.

Mr. SCHROCK. Mr. Hess, do you have any comments on that?

Mr. HESS. Only that I do not speak of course from a profit perspective, as everyone else here does. I am speaking for the nonprofits. But in terms of how it would help the Postal Service, we believe that some stability in the rate structure is going to keep the volume of mail from the nonprofits up higher than it ordinarily would if there is not stability in the rate structure.

Mr. SCHROCK. Yes, I understand. There are some who believe that the U.S. Postal Service will soon be obsolete due to the high-tech types of things and little machines like this that all of us seem to carry. Why is there a place for mail in this economy? By asking that, I am not suggesting there is not. I believe there is, but I would like to get your spin on it.

Mr. HESS. From the nonprofit perspective, we are unlike businesses in that so many of us do not have computer terminals like a business is often equipped to do. We have to rely on the U.S. mail and we do.

Mr. DAVISON. When computers were invented, everybody said we were going to get rid of all sorts of paper in the office. I do not

know about your office, but mine is still filled with lots of paper. When the video cassette came out, they said that movie theaters were going to go away. When e-mail came out, everybody said that people will stop sending greeting cards. None of those things have happened. There is a place for hard-copy correspondence, and there is keepsake value of certain things that come through the mail. There is just intrinsic value that cannot be harnessed in other ways. So I do not see the mail system as obsolete. It may go through increases and decreases in volume and load, but I think through some of the ideas that you have heard expressed here and elsewhere, there is an opportunity to continue to stimulate that demand.

Mr. SCHROCK. I agree. When I finally leave Congress some day, I want to come back and be the person that sells paper to this place. [Laughter.]

I can make a fortune.

Mr. Mulloy.

Mr. MULLOY. I would add to that, and probably even emphasize it more, that if you look at what has happened to most of the computer-driven business models, they have greatly enhanced their utilization of the mail to converse with the customers that they tend to prospect through the computer. It is an irreplaceable communication device that is important to the fabric of our country and our economy. For us to underserve it and underutilize it in the future or today is a crime. I think what we are really arguing for, all of us here, is that there are growth opportunities in this channel. It is not an obsolete channel. It in fact is an incredibly positive communication device for our economy.

Mr. SCHROCK. Yes, thank you.

Mr. Davis.

Mr. DAVIS OF ILLINOIS. Thank you very much. I thought for a moment there that you would come back as the Postmaster General. [Laughter.]

Mr. SCHROCK. That wouldn't be all bad either.

Mr. DAVIS OF ILLINOIS. Well, lots of work to do.

Gentlemen, let me thank you so much for your patience and also for your testimony. During the last discussion, we heard a great deal about financial transparency. Do you think that perhaps an outside auditor or some other independent source should certify that the data we are getting from the Postal Service in terms of product costs, financial results and other data are complete and usable to make decisions and determinations about it?

Mr. MULLOY. I guess I would say, sir, that I believe that the people of the Postal Service are a very high integrity, very highly intelligent group of people. I think they have the ability to fully assess and evaluate the data that exists about their business. I think what we would encourage you, and I think from the thrust of the two panels today you have heard us say that what we are really asking is that they be empowered to take the actions that such an analysis would in fact lead them to. That is the biggest single need. They have the access. They have the ability, and we all I think are very complimentary of the people of the Postal Service in terms of their capabilities in that area.

Mr. DAVISON. I would agree with Mr. Mulloy. In most respects, I will differ slightly from his comment in one area. I have the utmost trust and respect for the job that our current postal officials are doing. I have been very impressed as I have gotten to see their work and their approach. I believe they are very serious about improving their system. But just as we have outside auditors, I do not think it is a bad thing to have checks and balances. I like the idea of making sure that reports and figures in particular are free from any material misstatement; that there hasn't been any incidence of improper reserves. There are lots of judgments that go behind putting financial statements together. It is good to have an outside body, plus consistently applied rules, in our case general accounting principles, that help guide that.

I also think that we have a regulatory process that has come under some fire. In some respects, the regulatory process has worked in protecting the citizen interests quite well. But what I think everybody would agree with is the process has been complex and expensive. Part of that is the financial transparency issue. It takes a lot of time to get information and get data because the system is set up to be litigious and confrontational. In a confrontational environment, you do not want to lay your cards on the table. So I think that is part of the drive that really gets to your question also, Congressman.

Mr. DAVIS OF ILLINOIS. Let me ask you, we have recently found a couple of pots of money, like at the end of the rainbow there is a pot of gold. We found it for the Postal Service. I mean, what external auditing activity or look-see by others maybe would have found that money sooner? Could we perhaps have known about it a little sooner?

Mr. DAVISON. In a risky statement, I would say that I think it probably would have, because I think what has happened, as Mr. Davis is saying here, is that the Postal Service over a period of time felt unable to challenge some of the numbers that were being assigned to it by the government, by the Treasury. The reality was that perhaps some additional ability to challenge those numbers would have helped unearth the fact that they were being incorrectly charged over those very many years.

I think that is the same issue I am raising now with what they have done in the appeal to the Board of Actuaries, is that they have an outside party that is saying the prior methodology is the predominantly used methodology for firms facing the same issue of two-employer allocations based on years of service. We need to listen to those people when they bring those kinds of facts forward, and in fact react to it. That does not mean you blindly accept it, but you certainly listen to the learned input from outside bodies.

Mr. DAVIS OF ILLINOIS. I raised the issue earlier relative to management. I don't know if either one of you would hazard to make any recommendation to the postal system. As we go through this process, I do suggest that they have more people to be accountable to. I suspect that labor issues are going to become a concern as we reconstitute, reform, do whatever it is that we do.

Would you have any recommendations as to how the labor issues may get handled as we look at some transformation?

Mr. DAVISON. I am not a labor expert. I do not want to offer myself as such. But I do think that we have to pull everybody into this effort, and all understand where our selfish and enlightened best interests lie. It is really not about paying people as little as we can pay them. It is about having a viable system that brings value and adds value. I think the answer to some of the specific labor questions that were raised in the Commission's report—I am not an expert, I am not familiar enough to understand the alternatives or history—but I think it is important that we take a comprehensive view and work together to get this issue solved.

Mr. MULLOY. I would add to that I think that there should be a partnership at the table, because what we are trying to focus on here is the growth that is inherently present, we believe, in the system. Therefore, that is good for labor, it is good for management, it is good for the entire institution. That builds continuity and longevity in employment. It guarantees pension benefits and health care benefits for retirees. It is good for all constituencies and all stakeholders, if you will, in the business.

Mr. DAVIS OF ILLINOIS. I guess finally, universal service as we have heard it described, I would assume that you all are in agreement with that. What about the issue of collective bargaining? There are some people who feel that collective bargaining puts management at certain kinds of risk, and puts even an entire operation at certain kinds of risk. Do we have any feelings about that, or any comments that you would venture relative to that?

Mr. MULLOY. I think that the experience would say that there is some role for arbitration in the process of negotiation. I think that it cannot be an arbitrary arbitration. It should be in fact supported by both parties and provide some stability to it. I think that a good dialog between both parties is the most critical element. I would say that based on everything that I have seen in the last few years that a positive relationship has been generated between both labor and management at the Postal Service. I think there is a constructive dialog that is going on today, recognizing both the opportunities and challenges that are present. I think that if we can put the right sets of reforms in place and your committee can help us do that, then I think it creates an environment where both parties can have positive and constructive dialog, even when there are issues between the two.

Mr. DAVIS OF ILLINOIS. Thank you.

Mr. DAVISON. I would concur with that. My goal is to see the Postal Service become viable in the future, not to eliminate collective bargaining per se. My experience with change in an organization is that you have to get everybody on board, and this is a very large organization, 750,000 employees or so. Change does not happen just because managers decide change is going to be occurring. Change happens because the people that actually do the work embrace that change and move things forward. I think without bringing people on board and hearing what they have to say, understanding what their needs and concerns are, we are not going to have meaningful change. It is just that simple.

Mr. DAVIS OF ILLINOIS. Gentlemen, I thank you very much for your patience, and certainly for your participation. Mr. Chairman, I have no further questions, and yield back my time.

Mr. SCHROCK. Thank you, Mr. Davis.

As all of us consider the essential components of comprehensive postal reform legislation, what in your views are the key areas that we should include in that legislative package?

Mr. HESS. From the nonprofit perspective, it would be rate stability. We still prefer some form of indexing, whether it be pegged to CPI or inflation or whatever. That is important to us.

Mr. SCHROCK. Mr. Davison.

Mr. DAVISON. From a consumer and marketing perspective, even pegging something to inflation is a bit of a concession. Lots of product pricing in my industry and others go down regularly. So I think we should look for some real cost improvement in the system that will make it a more viable system and bring more value for the participants.

I would also add some strong consumer protection or citizen mailer protection; some sort of regulatory checks and balances. I do not think anybody has been advocating for an unregulated monopoly. That is essential, and whatever mechanism you choose to employ, there are a variety of them, but some consumer protection is absolutely essential.

Mr. SCHROCK. Mr. Mulloy.

Mr. MULLOY. I would just say that there are two that I would first and foremost jump on, one of which would be a comprehensive and total dealing with all of the retirement issues that are on the table, from health care benefits, CSRS, the pre-1971/post-1971 issues I raised, and the military. I think there are four issues there, all of which can be dealt with and there will still be a surplus of funds which then is an opportunity for the Postal Service to really embark on a true system of reform as outlined by this body.

The second thing would be that the Postal Service be empowered to utilize pricing for what in reality pricing is within a business environment, which is an opportunity for growth. The most successful retailer in America, one of our largest clients, in fact utilizes price reductions as a way of encouraging growth. They grow revenue through price reductions because they encourage the kinds of behavior that attracts market share and performance. We believe that those opportunities, and I think the panels have all indicated we see growth opportunities in this channel, that mail is an untapped potential in terms of growth. Price can become a major empowerment to attract growth.

Mr. SCHROCK. I have one final question, and it is a followup to that question. What do you think we absolutely should not include in this postal reform legislation, or what areas might best be addressed outside of legislation?

Mr. DAVISON. That is a difficult question.

Mr. SCHROCK. I did not say it would be easy.

Mr. DAVISON. And there are a lot of things that I could envision in ways to answer that.

From my perspective, I guess I would say I think this is something that we are going to do every three decades or so, and this is going to have lasting import. So I think it is important to try to put in place a structure that has some permanence, to not try to legislate too many details. In my own judgment, to Congressman

Davis' question, there is a broader constituency here that we need to serve, but that is not a lot different than a business serving its customers. So I think we have to establish some ground rules and then put some essential checks and balances in place, and hopefully the wisdom of those folks and the guidance that you provide will allow us to have a good, stable, durable system without your having to cover every detail.

Mr. MULLOY. I would kind of suggest that—and I would hope that the work of this body would be not looking at the mail channel that represents about 9 percent, as you have heard, of our gross national product, employs 9 million people—that in fact this is not a stressed industry that is going out of business, and that we are looking at an inevitable spiral; that we in fact come up with a package of reforms that truly recognizes there is opportunity for fulfillment in this business and that we put things in place that allow it to make better business judgments, that will allow it to recognize the destiny that is there for the Postal Service and for every one of its associates.

Mr. SCHROCK. Mr. Hess.

Mr. HESS. I do not have anything to add to that, Mr. Chairman.

Mr. SCHROCK. OK, thank you.

Let me conclude by saying, when I asked to come on this panel, I came on this panel with preconceived notions about what I thought the Postal Service was and what needed to be done. It is kind of interesting, in the three hearings we have had, and especially the one we had in Chicago and the one we have had today, those preconceived notions have been destroyed, because thanks to people like you and the first panel, and the wonderful folks we had in Chicago, I think I understand this better. I think the more of these hearings we have, the better able I am going to be to come to a final conclusion on what is best for America and of course what is best for the postal system.

So this has been very, very beneficial to me. I can tell you, I thank you all very much. I thank all the witnesses for appearing today, and I want to thank the staff who have done a magnificent job. These things are not easy to set up, especially when you go out of town like we did to the Windy City. I say that with all due respect, by the way. I really appreciate your efforts as well.

The record from this hearing will be kept open for 2 weeks to allow witnesses to include other information in the record. Again, I thank you all and this hearing is now adjourned.

[Whereupon, at 5:05 p.m. the panel was adjourned, to reconvene at the call of the Chair.]

[Additional information submitted for the hearing record follows:]

February 10, 2004

TESTIMONY BEFORE HOUSE GOVERNMENT REFORM COMMITTEE SPECIAL PANEL ON POSTAL REFORM AND OVERSIGHT

Christopher G. Cleghorn, President
Alliance of Nonprofit Mailers
Washington, DC

Mr. Chairman, thank you for the opportunity to continue our open dialogue with you and your colleagues on issues surrounding reform of the Postal Service. We continue to respect the process that you, your colleagues and your outstanding staff have created to find thoughtful answers to the complex questions before us.

The Alliance of Nonprofit Mailers represents hundreds of nonprofit organizations that, in turn, represent thousands of statewide and community-based affiliates and chapters. As a nonprofit executive with Easter Seals in Chicago, I also currently serve as the President of the Alliance. Our membership stretches throughout all segments of the nonprofit community — incorporating religious, charitable, educational, scientific and philanthropic groups.

America's charitable mission relies upon the mail to raise funds and disseminate information that serves our country and our communities. As you may know, my organization, Easter Seals, assists more than one million children and adults with disabilities and their families annually through a network of more than 90 affiliates and 450 service sites across the United States. To support this mission, we mail roughly 50 million pieces of mail per year.

We look to public policy decision-makers to protect and strengthen the Postal Service so that we may continue to rely upon mail as an affordable and reliable communications network. Throughout the recent deliberations — whether on Capitol Hill, before the President's Commission or in rate case proceedings — our message has been very consistent:

For nonprofit mailers, postal *reform* is all about postal *rates*. Every dollar saved from excessive postal rate increases is a dollar spent on the mission of the nonprofit organization.

The recent respite from back-to-back postal rate increases has been most welcome by America's nonprofit organizations. Prior to the passage of the retirement funding relief bill last year, we had experienced a crippling string of continuous rate increases. We thank you for your work in passing CSRS reforms last year. We know that without that bill we would be faced with additional postal rate increases *today.*

We also know that the relief won last year in the passage of retirement funding reform was only temporary. The Postal Service is already bracing to file for another rate increase in the coming months. Delaying additional, unnecessary increases — or mitigating the damage of such an increase — is good public policy to us.

Therefore, our first, and most important, request of Congress this year is to address the immediate fiscal stability of the Postal Service. We urge Congress to resolve the important issues surrounding the CSRS escrow fund and more fairly resolve the assignment of military service time costs for those USPS retirees covered in the CSRS plan. We also ask for your help in securing the necessary $770 million appropriation for the USPS costs associated with homeland security responsibilities, including mail irradiation and the USPS emergency preparedness plan. Federal agencies are the only mail recipients benefiting from the added protections of mail irradiation — those expenses should be met with appropriations from the Congress.

A fair and rapid resolution of these financial uncertainties will allow opportunities for the USPS to extend the current rate cycle and allow all of us in the mailing community an opportunity to increase mail volumes and fuel new growth for the Postal Service.

However, in the long term, 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.

We endorse many of the same proposals that were outlined by the President's Commission and included in the postal reform principles articulated by the Administration.

- **Implement Best Practices:** Reform should ensure that the Postal Service's governing body is equipped to meet the responsibilities and objectives of an enterprise of its size and scope.
- **Transparency:** Reform should ensure that important factual information on the Postal Service's product costs and performance is accurately measured and made available to the public in a timely and understandable manner.
- **Flexibility:** Reform should allow the Postal Service's governing body and management the authority to reduce costs, set rates, and adjust key aspects of its business in order to meet its obligations to customers in a dynamic marketplace.
- **Accountability:** Reform should guarantee that a Postal Service operating with greater flexibility has appropriate independent oversight to protect consumer welfare and universal mail service.
- **Self Financing:** Reform should ensure that a Postal Service operating with greater flexibility is financially self-sufficient, covering all of its obligations.

Of course, the USPS can unilaterally address many of the recommendations made by the President's Commission without the necessity of legislation. At the urging of the Congress, the USPS has embarked on an aggressive and productive Transformation Plan. Congress should continue to encourage USPS leadership in this direction and request continuous updates on the direction and progress of the transformation efforts.

When the Alliance testified before the President's Commission last year, we expressed serious doubts about clarity of financial reporting by the USPS — especially during rate case proceedings. And, as I mentioned earlier, we expect another rate case filing in the coming months. We are particularly concerned that the current process of compiling financial data, presenting financial data, filing multiple interrogatories about the reliability of financial data, etc., takes up months and months of the ratesetting process. Furthermore, disagreements between the PRC and the USPS over accounting methods add confusion and complicate the process, thus extending the ratesetting calendar. Postal financial information relative to postal ratesetting should be shared in an ongoing fashion with the PRC so that, when a new case is filed, the responsible agencies begin the process

with an identical understanding of the financial position of the USPS. Such a proposal would dramatically slash the time required to litigate rate cases.

We are also hopeful that new changes to the postal ratemaking process imposed by the Postal Rate Commission (PRC) in the recent rulemaking proceeding (RM2003-3) will introduce a new measure of transparency to rate case proceedings.

The President's Commission recommended a series of approaches to addressing the transparency of the USPS — including the imposition of an SEC-type of financial reporting. We understand that the USPS is acting independently to include enhanced disclosures in expanded financial reports. We applaud the USPS Governors and management for acting quickly to address this recommendation.

While we do not oppose recent efforts to construct an "indexed" style of postal ratesetting regime, we maintain concerned with any legislative approach that would diminish objective oversight of the USPS in the ratesetting arena. Past draft legislation on postal reform from the House of Representatives has proposed to limit postal rate increases to a Consumer Price Index (CPI)-based percentage increase reduced by an appropriate productivity adjustment — with no opportunity for exigent rate increases should the USPS fail to control costs. This is a reasonable approach to providing rate flexibility. Unless the USPS is required to operate within strict revenue limits bounded by the CPI-based increases, it will lose the incentive to improve efficiency.

As Congress considers granting new powers and authority to the USPS Governors and management, we also urge the addition of vigorous oversight by Congress and the Postal Rate Commission. The PRC should be granted subpoena authority in rate case and classification proceedings.

There are other lessons learned from the not-so-distant past that give us pause. If we could all rely upon the USPS to act responsibly, sensibly and with the overall needs of our national mail delivery network in mind whenever decisions are made or prices are set there would be little room for concern here. But too often in the past, USPS officials have been found to demonstrate faulty decision-making counter to the rational self-interest of the USPS itself.

Some nonprofit mailers were disappointed in the recent rulemaking process that altered the cooperative mailing regulations. When the proposed rule was first introduced, a thoughtful alternative was proposed by the Alliance of Nonprofit Mailers, the DMA Nonprofit Federation,

Independent Sector, the Association of Fundraising Professional and the Association of Direct Response Fundraising Counsel. If the USPS had better incorporated the proposals of this overwhelming block of the nonprofit mailing community, we would certainly have avoided the acrimonious fervor surrounding that final rule. The rulemaking process did not work well in that instance.

Mailers are currently wrestling with a series of new regulatory decisions imposed by the USPS having to do with mailing requirements, such as automation compatibility, mailpiece design, content and other somewhat subjective decisions that determine whether a mailpiece must be mailed at an expensive or affordable rate. In the past, the House Subcommittee on the Postal Service was very helpful in reviewing USPS policies on the imposition and collection of revenue deficiencies. We recommend that postal reform legislation consider stronger checks and balances over USPS authority in changing or altering substantial rules and regulations.

We recognize that postal reform is a very challenging task for public policy decision-makers. There are so many different points of view that must be considered and reconciled. We thank you for your willingness to listen to *our* views. As we have been in the past, the Alliance of Nonprofit Mailers stands ready to work with you and your colleagues to address meaningful postal reform in the Second Session of the 108th Congress.

Before the
House of Representatives
Committee on Government Reform
Special Panel on Postal Reform and Oversight

Statement of the
Association for Postal Commerce

February 9, 2004

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The Association for Postal Commerce (PostCom) represents many of the largest business users of all classes of mail; in short, PostCom is an association of many of the Postal Service's best customers. As such, PostCom has a strong interest in these postal reform proceedings, and in the financial viability of the Postal Service well into the future.

The Report of the President's Commission on the United States Postal Service has left no doubt that there is a critical need for reform of the laws and policies that govern the Postal Service. PostCom strongly believes that new legislation must be introduced and passed in this session of Congress if the Postal Service is to be transformed into an effective and efficient public enterprise, capable of providing affordable universal postal services well into the future. The time to act is now.

PostCom has participated in the process that led to the issuance of the report of the President's Commission, and generally supports many of the recommendations in the report. We have also worked closely with our members to develop our Association's recommendations for Postal Reform. In developing our recommendations, we have reviewed the final recommendations of the President's Commission, and the latest Congressional legislative proposals, and have attempted to develop a coherent perspective of what kind of changes reform legislation should induce.

PostCom has presented this perspective in the form of eight essential elements, as follows:

Fix CSRS and Military Benefits

Require Bottom Up Costing

Enable Pricing Flexibility

Expedite the Administrative Process

Define Universal Postal Services

Optimize Management Authority, Incentives, and Pay Comparability

Maintain the Mailbox Monopoly

Strengthen Regulatory Oversight/Transparency

These principles – taken together – spell FREEDOMS. PostCom believes that if these essential elements are all addressed in postal reform legislation: (1) the Postal Service will obtain the necessary freedoms to maintain rate stability, to price efficiently, and to transform its network; (2) mailer-customers will attain the freedom to purchase the delivery services they need, with open access to the postal network at efficient prices; and (3) the American Public will preserve its freedoms of access to information, services, and goods at reasonable prices.

These elements provide the necessary conceptual framework, and organizational opportunities and incentives for postal reform, under the oversight of a new, independent, regulatory body. Further, we believe that these essential principles provide a realistic balance of the competing interests on these matters, and provide abundant safeguards to prevent the Postal

Service from unfairly competing. We therefore urge the Members of this Committee and the House to move forward in developing legislation that will realize these principles.

1. Fix CSRS and Military Benefits

Prior to P.L. 108-18, the Postal Service was required by statute to make specified amortization payments to the Civil Service Retirement System ("CSRS") fund regardless of whether that over funded or under funded its payout obligations. Following review of the Postal Service's contributions and obligations to the CSRS at the behest of the General Accounting Office (GAO), the Office of Personnel Management (OPM) determined that the fund was on pace to be over funded by $78 billion. As a result, the Administration proposed legislation to correct the over funding of these benefits. P.L. 108-18 corrected the over funding by requiring that future annual contributions to CSRS be dynamically funded based on the actual benefit costs resulting from that year's service. It also established an escrow arrangement for FY 2006 and beyond, pursuant to which the funds may be released once an understanding is reached of how the Postal Service would use the "cost-savings" –or more aptly, overpayments.

In theory, the legislation would eventually relieve the Postal Service of billions of dollars in annual payments. However, when OPM calculated the Postal Service's current and future CSRS obligation, it assumed that the Postal Service was responsible for benefits associated with military and volunteer service time. That assumption was codified in P.L. 108-18. Further, in preparing its response to GAO, OPM changed the long-standing method used to allocate postal employee pension obligations between the Treasury Department and the Postal Service. The Treasury Department was historically responsible for obligations caused by employee service at the old Post Office Department (POD). The Postal Reorganization Act of 1970 provided that the

Postal Service should be responsible for the obligations associated only with employee service after the 1971 reorganization. The OPM shifted tens of billions of dollars in POD obligations to the Postal Service. Under P.L. 108-18, the Postal Service can appeal this change before an OPM appointed actuarial board, and is doing so.

These changes to the Postal Service's pension obligations are historically incorrect and simply unfair. Unless rectified, their results threaten the viability of the postal system. Until P.L. 108-18, the Postal Service -- like all other CSRS participants -- was *not* obligated to cover military and volunteer service time benefits for its employees and retirees. Thus, P.L. 108-18 places a new and unique burden on the Postal Service – responsibility for CSRS benefits associated with a postal employee's military and volunteer service time, including such benefits that accrued prior to the employee commencing employment with the Postal Service. And the OPM's new allocation method burdens the Postal Service with POD obligations, an action that the 1970 Postal Reorganization Act meant to avoid.

The Postal Service is a self-supporting government entity; its customers cover its costs. Its customers should not be required to subsidize taxpayers and the U.S. Treasury by covering the costs of retirement benefits associated with a postal employee's military and volunteer service time and POD obligations. Postal Service customers are taxpayers too. Congress should not impose what amounts to a hidden and discriminatory federal tax burden on entities that use the mails to conduct their business. This problem must be corrected. Legislative action is required to permanently transfer responsibility for all pension costs for CSRS and FERS employees attributable to military and volunteer service to the Treasury Department, and to reverse OPM's transfer of POD obligations to the Postal Service.

In sum, PostCom believes that the Postal Service should be relieved of the escrow obligation and responsibility for pension costs for military, volunteer and POD service that is properly attributable to the U.S. Treasury. However, PostCom does not suggest that this should result in effectively issuing a blank check to the Postal Service. If these excessive Postal Service obligations are corrected, the "cost savings" (overpayments) should be used to delay and moderate future rate increases, and prefund currently unfunded postretirement health benefits obligations. The savings should not be used for additional debt repayment or capital investment: If the Postal Service is to be managed prudently as a government enterprise, decisions regarding repayment of outstanding debt and capital investment should be independently justified using standards comparable to those applied in the private sector.

2. Require Bottom Up Costing

By "require bottom up costing," we mean that the regulatory framework should require that the Postal Service develop and propose baseline and new rates based on the costs of resources consumed through services provided at various points of access to the postal network.

To explain this point, we provide a bit of background on the current Postal Service cost accounting methodology. The current methodology centers on the mail subclass, that is, a group of mail that receives the same service level and has similar operational and market demand characteristics. For example, First Class mail has one subclass for letters, cards and flats, and another for Priority Mail; Standard Mail has one subclass for Standard Regular, and another for Enhanced Carrier Route. Subclass centered costing looks at average cost causation by class of mail, rather than the services or activities the Postal Service performs. A significant percentage

of postal costs cannot be traced back to any particular class of mail, and these are referred to as "institutional costs".

Unlike subclass based costing, "bottom-up costing" will provide information on the actual costs associated with resources that are consumed to provide services at various points of entry in the postal network. For example, within the Standard Mail class, mail can be entered at an origin bulk mail acceptance facility, an origin bulk mail center, an origin sectional center facility, a destination bulk mail center, a destination sectional center facility, or a destination delivery unit. Mail entered at an origin point will incur considerably greater processing and transportation costs than mail entered at a destination point. We believe bottom-up costing will result in greater financial transparency.

Furthermore, bottom-up costing will promote worksharing, the private sector – public sector partnership that is the only means of achieving the lowest combined cost for mailers. Under the current regulatory framework, rates are designed to cover attributable costs, plus a markup of a share of the non-attributable, institutional costs. A base rate for a subclass is derived. Worksharing by mailers is reflected as a discount off of the base rate, and calculated on the basis of the costs the Postal Service "estimates" it "avoids" from the mailer's effort. When the discount inadequately reflects the costs of the activity, worksharing does not occur. With "bottom-up costing," when the costs attributable to particular postal activities become transparent, more worksharing opportunities will become apparent. And instead of designing worksharing discount (down) from the base rate, the Postal Service would be more likely to design a workshare rate (up) to cover the costs of resources actually consumed.

By requiring bottom-up costing and giving the Postal Service pricing flexibility and management incentives, with proper regulatory oversight, the postal economy will be better able

achieve the most economically efficient private sector – public sector combination of postal services. Simply stated, "bottom-up costing" is the key to the movement of the mailing industry towards the unbundling of services and open access to the network analogous to that which has already been legislated and achieved in the telecommunications industry.

3. Enable Pricing Flexibility

The Postal Service simply must have greater pricing flexibility to run its business in a changing market environment, and to meet the evolving needs of customers. However, we are also acutely aware that the Postal Service is a monopoly, and there must be competent regulatory oversight over the rates and terms of service of non-competitive postal products. Therefore, PostCom supports pricing flexibility in the form of incentive-based rate regulation.

Incentive-based rate regulation, and more specifically, rate ceilings (price caps) on non-competitive products, would provide Postal Service managers with greater flexibility to respond to the market place and customer needs, while imposing cost control discipline. Together with relieving the Postal Service of the breakeven constraint and incentive-based compensation, rate ceilings will induce postal management to realize new efficiencies, and enable postal management to respond to price sensitivity.

Congress should legislate an expeditious administrative process for determining baseline rates for non-competitive services, and should provide clear guidelines that baseline rates be predicated not only on cost causality, but also on market demand, price sensitivity, and other competitive conditions. Congress should also legislate a simple, straightforward design for a rate adjustment factor by combining an inflator with a productivity factor. Baseline rates, as well as any changes to the rate adjustment factor, and reclassification of any non-competitive service as

competitive may be litigated before the new Postal Regulatory Board (the need for which we will describe later). Congress should not step away from its responsibility to establish the initial regulatory scheme – but any detailed improvement to the initial framework may be litigated before the Postal Regulatory Board. With the exception of requiring financial transparency and proscribing cross-subsidies of competitive services by non-competitive services, rates for competitive services should be virtually unregulated.

4. Expedite the Administrative Process

The current ratesetting process can take as many as eighteen months. It is a burdensome and costly process for both the Postal Service and its customers. And the delay between the time the Postal Service proposes new rates, and the effective date of these rates ensures only that the Postal Service cannot respond effectively to changing economic conditions or current business opportunities. This burdensome ratemaking process should be abolished.

By enabling pricing flexibility, requiring bottom up costing and demanding greater financial transparency, Congress will go a long way towards expediting the administrative process. The current ratemaking process will be obsolete – it should be eliminated in favor of periodic proceedings to review proposed changes to the rate adjustment factors. Rate changes within the limits of annual rate ceiling adjustments should be subject only to after-the-fact review. And Congress should legislate statutory deadlines of four or five months for completion of any necessary administrative processes.

Legislation should limit evidentiary, trial-type hearings only to specific types of proceedings. PostCom believes that under its proposed rate ceiling framework, trial-type hearings are probably only needed in proceedings which involving a change in the design of the

rate adjustment factor, a change in the classification of a non-competitive service to competitive where there is evidence submitted to the Board that the change may be discriminatory or impairs the ability of the Postal Service to meet its universal service obligation, or in complaint proceedings where the Board finds there is a material question of fact that cannot be resolved on the basis of the pleadings.

These legislative changes will go a long way to expediting – and reducing the expense of – the administrative process.

5. Define Universal Postal Services

PostCom supports the recommendation of the President's Commission that the U.S. Postal Service be retained as an independent agency of the Executive Branch, and operated primarily as a self-sufficient service provided to the nation for the purposes of communication and commerce. We also agree with the premise that the Postal Service should focus its energies and resources on providing essential "core" postal services and refrain from those that are not essential to its primary mission. To this end, PostCom would support legislation that basically limits the definition of "postal services" to the physical delivery of letters, printed matter or packages. Aspects of physical delivery include such activities as acceptance, collection, verification, sorting and transportation, and directly related services and functions. We believe the Postal Service should be prohibited from performing any non-postal functions, with the exception of certain government support functions for which it can be fully and directly compensated. Its involvement in electronic information systems should be confined to those which are ancillary and directly support the performance of its core mission.

The time is also ripe to define what is meant by "universal service". Most people seem to assume that universal service means the service we have now, and fail to recognize that this service is not the same in all areas of the country. A definition of "universal service" must recognize existing local variation, and cannot be so broad as to extend mail service beyond those types of points at which mail is now available. Universal service may not now, and may not always require daily delivery, six days a week to all mailing addresses. At the same time, universal service is a fundamental issue of public policy and any changer in the scope of that bedrock principle should be made by – and only by – Congress. So legislation should define universal service for now, and require the Postal Regulatory Board to periodically reexamine the proper scope of universal service, and report back to Congress regarding the need for further legislative reform.

6. Optimize Management Authority, Incentives, and Pay Comparability

PostCom believes that postal legislation must optimize the incentives that underlie the legislative and regulatory framework of the postal system to foster more rational, economically efficient, business-like behavior. To complement rate ceilings, several other important changes to the regulatory framework are necessary to create these incentives. First, the breakeven constraint must be eliminated. Simply, in our capitalist system, we are motivated by profits. The breakeven constraint is stifling efficient behavior, and excessive profits can be otherwise effectively controlled through a price cap mechanism that is closely monitored by an active, competent independent Postal Regulatory Board.

Second, postal officers and employees must be given compensation comparable to the private sector - where total compensation is tied to productivity gains – in order to induce

economically efficient behavior. Analysis of pay comparability for postal management and labor should take into consideration the total compensation of the officer or employee, including all benefits.

Finally, the Postal Service must be authorized to close or consolidate facilities, to the extent such actions do not substantially impair its ability to provide universal service. If the Postal Service is to be operated along the lines of an efficient private enterprise, Congress must remove the Postal Service network and facilities from the political arena, and enable the Postal Service to manage its network and facilities with a private sector eye towards operational efficiency.

7. Maintain the Mailbox Monopoly

Only the Postal Service is currently permitted to have access to the nation's mailboxes (18 U.S.C. § 1725). In light of the results of a consumer survey recently conducted for the President's Commission, and a 1997 GAO report, PostCom supports retaining this aspect of the postal monopoly. Furthermore, the postal monopoly is a public good; therefore, the Postal Service should not be free to contemplate revenue opportunities that may be associated with opening up the mailbox to private businesses outside of the legislative process. Therefore, PostCom would support legislation restricting the Postal Service from adopting regulations to alter the scope of its mailbox monopoly, and requiring the Postal Regulatory Board to report to Congress where changes to the scope of the monopoly are needed.

8. Strengthen Regulatory Oversight/Transparency

The existing Postal Rate Commission basically has only the narrow authority to issue recommended – non-binding – decisions on mail rates and classifications, and fees for postal services. In our view, this authority is woefully inadequate even under the current regulatory framework. But it is even truer that as the Postal Service is provided with increased pricing flexibility and expanded management authority, the scope of regulatory review and regulatory authority must be strengthened. At the same time, the powers of the new agency must be carefully defined. It should not be permitted to become a super agency which effectively exercises veto powers over all Postal Service activities. Its role should be confined to the prevention of monopoly abuse in two key areas – prices and service, including quality of service -- and its decisions in these areas must have teeth.

A legislative proposal for postal reform must empower a new and competent Postal Regulatory Board, with broader oversight authority, to review not only the baseline rates and rate increases, but also the terms and conditions of service the Postal Service offers, and the quality of the service the Postal Service provides. Regulatory oversight of service is of equal importance as rate regulation in order to ensure that the Postal Service does not elect to sacrifice quality for the sake of its bottom line.

In light of the expansion of this authority, Congress should require that appointees to the Postal Regulatory Board have demonstrated expertise and experience relevant to the regulation of large complex business or utility entities.

In sum, the new Postal Regulatory Board must have binding authority, subject only to judicial review, to review rate increases for non-competitive products, ensure that revenues from

non-competitive products are not cross-subsidizing competitive products, ensure that the Postal Service is appropriately accounting for and allocating its costs, ensure financial transparency, obtain information from the Postal Service, through the use of subpoena power if necessary, and review complaints regarding rates, terms, conditions or quality of service.

* * *

In conclusion, taken together, the changes PostCom advocates are designed to create the legal and regulatory structures necessary for the Postal Service to reform and transform itself into an effective and efficient public enterprise, responsive to its customers.

We welcome any opportunities to further explain our proposal, and look forward to seeing this Committee's further deliberations, and Congressional action which is so critically needed at this time.

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February 11, 2004

TESTIMONY OF JOHN FELLOWS, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, DHL WORLDWIDE EXPRESS, INC., BEFORE THE SPECIAL PANEL ON POSTAL REFORM OF THE COMMITTEE ON GOVERNMENT REFORM

Good afternoon, Chairman McHugh and members of the Special Panel. My name is John Fellows and I am the Chairman and Chief Executive Officer of DHL Worldwide Express. First of all, I would like to thank you for the opportunity to testify today and to recognize Chairman McHugh and other members of the Panel for your leadership on the many complex and sometimes contentious issues affecting the future of the U.S. Postal Service.

DHL: Who We Are.

Please allow me to preface my remarks with some basic information about our company. DHL Worldwide Express, Incorporated (DHLWE) is a U.S. company, headquartered in Plantation, Florida, that operates the DHL express delivery network in the United States. Our parent company, DHL International, is Belgium-based and owned by Deutsche Post World Net (DPWN), a publicly-traded German corporation that, among other things, operates Germany's national postal service.

DHL, which was founded in 1969 by a group of American entrepreneurs, has been a pioneer of international air express delivery service and today is a global industry leader. The DHL global network serves more than one million customers located in more than 220 countries and territories worldwide, handling 160 million shipments each year, of which more than 31 million are carried to or from the United States. DHLWE provides close to 40,000 jobs for Americans across all 50 states and accounts for the jobs

of thousands more who work for other U.S. companies that provide support services for the DHL network in the United States. For example, although DHLWE operates its own ground services, we contract for all of our airlift in the United States from air carriers licensed by the Department of Transportation, including ASTAR Air Cargo and ABX Air.

This is an exciting time for DHLWE. Just last year, the Company acquired the ground assets of Airborne Incorporated, thereby substantially expanding the scope of our U.S. network and establishing ourselves as the third largest express delivery service provider in the United States. Although our market share remains far smaller than those of Federal Express and UPS, we see exciting opportunities for growth due to our enhanced ability to offer U.S. shippers an attractive and viable competitive alternative. We also have ambitious plans to develop our logistics business, which is further increasing our competitiveness by enabling us to offer customers an integrated package of express delivery and inventory management services.

The Postal Service Should Focus on Its Strengths.

All businesses that function in the courier, express, and postal markets today face significant challenges, not only from each other but also from alternative methods of communicating and doing business. In this respect, the Postal Service is no different from any other competitor. The Postal Service has a unique asset, however, its universal delivery network which operates nationwide and with a daily frequency of delivery has also evident limitations and is very costly. According to both the President's Commission and the General Accounting Office, the Postal Service's business model is

outdated, its organizational structure too inflexible, and its costs are excessive. The key challenge for the Postal Service, as well as law and policy makers, is to determine what changes are necessary to preserve a universal delivery network that is efficient and beneficial to consumers.

In fact, the American postal system can be viewed as a network of services supported by a wide variety of functions, of which delivery is merely one. Mail collection, processing, and transportation are other essential elements. Not surprisingly, the Postal Service performs some of these functions better than others. The Commission recommended that the Postal Service focus on its core strengths, particularly the first and last mile of its mail delivery stream, but, in other areas where Postal Service functions can be better and more efficiently performed by private sector companies, the Postal Service should outsource to the private sector. Simply put, outsourcing, or worksharing as it is frequently called, substitutes lower cost private sector resources for the more expensive resources that would be provided by the Postal Service, while also affording customers competitive postal network access. This not only creates a mutual benefit for the Postal Service and its private sector partners, but also improves the quality of service to the customer. The Postal Service should be given the necessary incentives to further develop such productive cooperation with the private sector.

DHL is Both a Competitor and a Partner of the Postal Service.

DHL is well positioned to offer a distinct perspective on these issues because we are both a competitor and a strategic partner of the Postal Service. That competition occurs primarily in the market for domestic express parcel delivery services. DHL,

however, through Airborne Express, also has partnered with the Postal Service to create the innovative and successful *Airborne@Home* program, under which DHL/Airborne acts as an expeditor, picking up large volumes of parcels from major shippers, then moving these parcels through our air and ground linehaul network and delivering it to the local post office located closest to the consignee. From there, the Postal Service then delivers the parcel the "last mile" to the customer's residence. As part of the *Airborne@Home* program, we have integrated our world-class tracking system with the Postal Service's Delivery Confirmation offering to provide door-to-door tracking throughout the package delivery process. We have a number of variations of the service, but our standard offering provides two-to-four-day, door-to-door final delivery to residences. *Airborne@Home* competes with 1-6 day ground delivery offerings, but offers quicker delivery for the price. It's a program that benefits the Postal Service, DHL/Airborne, and our customers.

DHL also has a separate arrangement with the Postal Service whereby DHL provides air linehaul transportation in support of the Postal Service's *Global Express Guaranteed* service for deliveries outside the United States. This cooperative relationship enables the Postal Service to enhance its own network and services by accessing the networks of private sector express delivery providers, and vice versa.

It's also worth noting that the Postal Service's cooperation with the private sector is not limited to express delivery companies. For example, the Postal Service is establishing relationships with major U.S. retailers in an effort to market its products through locations other than post offices, such as grocery stores. The Commission's

report recommended that the Postal Service expand these partnerships as a way to reduce costs and improve customer service.

The emergence of this dynamic marketplace, with its multi-faceted forms of competition and cooperation between the public and private sectors, suggests a number of conclusions:

- First, the Postal Service's universal delivery network must be preserved and made more efficient.
- Second, it simply is unrealistic (and not even necessarily desirable) for private-sector express delivery companies to expect Congress somehow to quarantine the Postal Service and the monopoly mail sector from the competitive marketplace in which we operate; but,
- Third, the Postal Service should focus on its core strengths, which the Commission has identified as the first and last mile of its mail delivery stream, while outsourcing to private sector companies when they can perform Postal Service functions more efficiently.

The Report of the President's Commission and the Support of the Administration Provide New Impetus for Change.

DHLWE applauds and strongly supports the efforts of this Congress and the Bush Administration to confront the fundamental challenges facing the Postal Service. We regard the report of the President's Commission as an important event that has provided new impetus for a fresh approach and we welcome Congress's vigorous response to the report, as exemplified by the work of this Special Panel. DHLWE fully recognizes the importance of universal postal service to U.S. businesses and residents, and to the U.S.

economy in general. We also are aware of the serious problems confronting the Postal Service today and the need for the Postal Service to become more efficient while preserving (and, as necessary, adapting) universal service to meet the demands of a highly dynamic economy and operating environment. The Commission's report offers a thoughtful critique and some recommendations, but also leaves many issues unresolved and open for further discussion and debate.

In response to the Commission's report, the President has expressed support for postal reform, but the Administration, in the words of Treasury Under Secretary Roseboro when he testified before this Panel on January 28, has chosen not to be "overly prescriptive." Instead, the Administration has offered five general principles to guide the congressional debate, emphasizing that reform should focus on enabling the Postal Service to:

- implement best commercial and business practices;
- enhance the transparency of its operations and performance;
- achieve greater operating flexibility;
- become more accountable; and
- be self-financing.

These are all laudable goals that DHLWE supports, and which serve to highlight the challenges that must be overcome if real change in the postal status quo is to be achieved.

Key Elements of Postal Regulation.

From the private-sector, express delivery service provider perspective, ours is truly a global business, and the reality is that, over time, competition is increasingly being

conducted on a global basis. As the competitive playing field grows ever larger, more global, and less segmented by national boundaries, and as public-sector postal service participation in the private sector increases, it is important to ensure that competition from postal services does not distort that playing field. As a general rule, DHLWE strongly advocates a free market approach to competition in preference to intrusive government regulation. The ability of a wholly government-owned and operated postal monopoly to compete in the private sector, however, must be predicated on reasonable, independent regulation that can ensure a level playing field and a properly structured market. In other words, the Postal Service should be allowed to compete, but subject to appropriate legal and regulatory safeguards to protect competition. Such regulation should incorporate the following elements:

- First, as the Commission recommended, the scope of the Postal Service's monopoly should be established by an independent regulatory authority, not by the Postal Service itself, and should be drawn narrowly.
- Second, as I have noted, in order to ensure the long-term viability of a universal delivery network, the Postal Service should follow the Commission's recommendation by focusing on its core business of delivering the mail, while outsourcing to the private sector related activities that can be performed more efficiently by others.
- Third, the Postal Service should be required to operate any competitive activities under a separate business entity and to apply transparent accounting principles to all of its activities, including accounting for its competitive activities separately from its monopoly activities. Such accounting should include an empirically

precise method of defining postal costs and properly allocating those costs between monopoly and competitive activities.

- Fourth, the Postal Service should be subject to the antitrust laws and other competition-related and consumer protection laws. DHLWE believes that such laws, if applied to the Postal Service and properly enforced, can provide sufficient safeguards for competition.

The Lessons of Postal Reform in Other Countries May Be Instructive.

In assessing how best to implement these fundamental priorities, the experience of other countries that have already undertaken comprehensive postal reform may be instructive. For example, the European Union and individual member states have issued directives implementing far-reaching changes that are effectively reinventing the ways in which universal postal service may be preserved and improved in the future. These include:

- Requiring each EU Member State to limit the scope of its monopoly postal sector;
- Implementing a phased transition toward eliminating postal monopolies altogether;
- Establishing independent regulatory authorities that, among other things, prohibit postal services from competing unfairly with private-sector companies;
- Ensuring that markets for express delivery services are open to competition, not just from EU companies, but from all players.

February 11, 2004

The process of establishing a consensus in support of these objectives and implementing them has been difficult and imperfect, particularly in terms of overcoming the long tradition of government-owned postal administrations in Europe and the additional complexities of creating uniform rules and standards that transcend national boundaries. Yet, despite these and other obstacles, Europe is now moving in the right direction.

This, however, is not to suggest that the EU experience necessarily should be regarded as a model for U.S. postal reform or that there should be a "one size fits all" approach—merely that other countries are making progress toward achieving the compatible goals of enabling postal services to be more efficient and self-sustaining, while preserving universal postal service.

* * *

Thank you for the opportunity to appear before you here today. I will be happy to answer any questions you may have.

Envelope
Manufacturers
Association

January 9, 2004

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The Honorable John H. McHugh
United States House of Representatives
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Washington, D.C. 20515-2332

Dear Rep. McHugh:

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. I have attached both in paper form and on CD-ROM versions of eight papers we have written on various aspects of postal reform. I would like to request that these documents be entered into the hearing record. While EMA is not going to testify at this time, I thought that these documents would be useful. Thank you for your consideration of them.

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 piecemeal 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, which 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

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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 has 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 Board 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 were 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 Mail (A) 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 it is helpful to place a required mediation step in the process, then they should have the flexibility to do so.

We felt that 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 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: With what do you compare these compensation programs? 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 feel 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. 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.

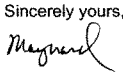
Technology

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

Enclosures

Greeting Card Association

TESTIMONY BEFORE THE HOUSE GOVERNMENT REFORM COMMITTEE SUBMITTED BY GCA PRESIDENT JOHN W. BEEDER OF HALLMARK CARDS, INC. WEDNESDAY FEBRUARY 11, 2004

The Greeting Card Association (GCA) represents two constituencies: the greeting card industry, and the individual household user of the United States mails, or the "citizen mailer." GCA has been active in postal matters for many years, and most often has been the *only* private-sector postal advocate for both the industry and the citizen mailers it serves.

We are pleased to have the opportunity to testify before the Government Reform Committee with respect to postal reform following 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 some of the most important thinking on postal reform since its reorganization more than thirty years ago. Such independent and impartial reviews of postal operations are rare, and therefore, should receive thoughtful consideration.

As with the Commission, our bottom-line objective is to ensure the continued viability of the United States Postal Service. In a time of historic declines in First-Class mail volumes, it is clear to us that this goal cannot be achieved through the traditional method of raising rates to cover ever-increasing costs.

GCA Core Principles

We appear before you today to argue for three core principles that have emerged from the debate over postal reform in Congress and subsequently before the Commission:

- 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 - is essential
- Congress must give the Postal Service the authority to control workforce and facility costs as set forth by the President's Commission; and
- A change in the Postal Service's business model to recognize the interdependency between high volume, low cost bulk mailing and mail types that individuals and households want to receive and depend upon.

We are deeply gratified that the need to preserve universal service has been widely acknowledged by the vast majority of the mailing community and affirmed by the Commission. In addition, virtually the entire mailing community has supported the permanent elimination of the escrow requirement for CSRS savings and the return of the obligation for postal employees' military service to the Department of Treasury. GCA is no exception. Our other priorities, however, continue to be the subject of a greater degree of debate and merit some detailed discussion. GCA believes no reform effort will be complete or successful if these core principles are ignored.

Regulation/Rate Setting

There can be no doubt that the role of the regulator in determining the pricing of postal products is a central question in the effort to preserve not only the viability of the Postal Service but also the essential checks and balances needed to protect the citizen mailer under a monopoly. That is why we strongly support the Commission's call for the creation of a "Postal Regulatory Board" with broad authority to regulate rates for noncompetitive products and services and new subpoena power to ensure financial transparency on the part of the Postal Service. Such a board would be very consistent with our priority of ensuring strong regulatory protection for the captive postal customer. We urge the incorporation of this recommendation into legislation.

The suggested process for setting rates, however, is a matter of great concern for our organization due to its impact on the citizen mailer and by extension, the Postal Service. The Commission has proposed the establishment of a rate-ceiling regime with only limited opportunity for after the fact review of any challenged rate. In our presentation to the Commission, GCA strongly advocated our long-standing view that the practice of prior review should be maintained in any future rate making system. Although GCA continues to believe that prior review is the only way of guaranteeing fair and equitable treatment for captive mailers, we have concluded that the benefits derived from the Commission's *comprehensive* cost control recommendations make it possible for us to accept an alternative rate setting system such as that proposed by the Commission.

Legislative Approach

Having acknowledged the possibility of a new mechanism for rate setting, however, GCA has also identified a number of critical details, 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, we would encourage the Committee to maintain the approach taken in the most recent version of postal reform legislation developed by Representatives McHugh and Waxman. They refrained from including specific rate setting provisions in legislation in favor of giving a newly constituted and empowered regulatory body a timetable and general guidelines and objectives for creating a new system. This 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.

We must stress, however, the importance, in creating a ratemaking system – and in legislatively establishing the principles that will guide the creation of that system – of ensuring that the benefits of streamlining and increased efficiency actually accrue to all postal customers, businesses and households alike. It is true the system must provide reasonable incentives for efficient performance by postal workers and managers. Still, the survival of the postal system as a whole depends on keeping its services available to the mailing public at attractive rates. Hence, even if the ultimate decision is in favor of a non-cost-based ratemaking system, such as a price cap, rates must be kept in line with the increasing efficiencies everyone expects from comprehensive reform. Such a system, therefore, should incorporate a periodic general review of rates by the regulatory body, from two standpoints: their overall fairness, and their alignment with the costs currently being experienced. For if mailers perceive that efficiencies are not being captured – or, if captured, are not being

reflected promptly in rates – they will inevitably look for alternative channels of communication, which would only further threaten the sustainability of the Postal Service.

Cost Control is Vital

We believe 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 directly dealt with in earlier legislative postal reform proposals, and one we believe is the key to a sustainable postal service. We cannot accept any postal reform legislation that fails to include provisions allowing Postal Service costs to be managed effectively. 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 an answer is no answer 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 question that accounts for nearly 80 percent of Postal Service costs. We respectfully submit that the Commission recommendations in this area represent the most critical addition to the body of work this Committee has done in the area of postal reform.

Workforce Issues

Accordingly, we offer the following observations with respect to the Commission's cost control recommendations requiring Congressional involvement. From our perspective, the seminal question relating to Postal Service labor costs is that of pay comparability. If postal worker wages and benefits are indeed out of line with the private sector, then that would suggest that the current process of collective bargaining is not conducive to the long-term viability of the Postal Service. On the other hand, if postal wage and benefit levels compare closely with those in the private sector, the case for making major changes in this area is diminished.

The Commission declined the opportunity to determine if, indeed, a wage and benefit premium exists for postal workers compared to private sector workers performing similar tasks. Instead, the Commission charges the new Postal Regulatory Board with making this determination. In this one area, we feel it necessary to recommend an alternative approach. The issue of wage comparability must be resolved prior to completing any comprehensive postal reform legislation. To that end, we urge Congress to use any appropriate means to settle this issue.

Recommendation: We suggest that the General Accounting Office be promptly assigned the task of reviewing postal and private-sector pay and benefit levels and making definite findings as to whether postal compensation is comparable. Of course, since circumstances may change, the new Postal Regulatory Board can and should be tasked with revisiting this initial finding from time to time.

With respect to other Commission recommendations, we agree that the process of collective bargaining should be improved. We also believe the Postal Service's pension and post-retirement health care plans should be included in negotiations for future employees and retirees- particularly if postal wages are found to be to be in excess of those found in the private sector. We also support granting the Postal Service relief from the Federal Employee's Compensation Act in order to make the changes set forth by the Commission and bring in line Worker's Compensation claims. Finally, the statutory salary cap should be repealed in order to permit the Postal Service to offer pay for officers and employees at levels competitive with the private sector.

Network Issues

GCA recognizes that the Postal Service does not require any additional authority from Congress to streamline its processing facilities and operations. Nor is specific approval needed to right size the postal workforce through attrition and to restructure postal management. We believe, however, that Congress should help set expectations and encourage the Postal Service to fulfill these goals. This could be done by eliminating any provision in the law that inhibits the closing of post offices and by passing language that clearly states Congress' intention to help the Postal Service achieve its optimum network. We understand that post offices account for only a small fraction of operating costs compared to large processing facilities, however, we believe Congressional involvement in decisions relating to post offices has set a tone that has discouraged the Postal Service from coming forward with a plan to optimize its network of larger facilities. We believe that beyond profitability considerations, the only criteria for determining if a post office or facility remains open should be its role in fulfilling the universal service obligation. This suggests to us that future post office closings in urban rather than rural areas might be the result of such a policy. In any case, we would argue that the Postal Regulatory Board, with appropriate guidance from Congress, is best suited to oversee these decisions and should be delegated that authority.

The success or failure of postal reform depends upon the degree to which these issues are addressed. Indeed, one possible reason that previous postal reform efforts failed to gain broad support among mail users was the perception that they did much less to bring about overall cost control than to reconfigure the pricing system (on which mailers hold an irreconcilably wide variety of views). Since different user groups have different views on pricing, only the promise of effective cost control can bring them together under a new regulatory system, and allow them to agree on its proper structure. 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 *only* the prospect of the benefit from cost management that allows GCA to accept, with considerable reservation, after the fact review of rates.

Core Value of Mail

Finally, we have also advocated 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.

If – as GCA strongly recommends – Congress decides that the new expert regulatory body should settle the details of ratemaking and regulation, then Congress should provide general guidelines that recognize the reality, and the growing importance, of the unique degree of "brand equity" enjoyed by the Postal Service in the eyes of the general public. That strikes us as the sort of general guidance that Congress can and should give to the regulators before they begin their task of designing a flexible, responsive, and effective system of postal ratemaking. The task before you, after all, is to strengthen and redirect a *public* institution, constitutionally committed to Congressional direction and oversight.

Summary

GCA is grateful for your interest in Postal Reform. We have concluded that the President's Commission has identified the critical areas in Postal Service operations requiring 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 the problems identified by the Commission are valid, and none should go un-addressed in any postal reform legislation. This is particularly true of their workforce and facility recommendations. The failure to deal with these issues would put in doubt the ability to gain broad based support from the mailing community including GCA. More importantly, it would jeopardize the continued viability of our nation's Postal Service, the goal for which this Committee has striven for so many years. We hope 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 partner with you in any way possible in this critical endeavor.

Respectfully submitted,

John Beeder

John W. Beeder
President

The Instant Web Companies

Total Package Production for Direct Marketers

James N. Andersen
President & CEO

Phone: 952-470-6405
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January 22, 2004

For the Public Record, House Government Reform Committee Hearing, February 11, 2004

The Honorable John M. McHugh
Special Panel on Postal Reform & Oversight
Government Reform Committee
2333 Rayburn House Office Building
Washington, DC 20515-3223

Dear Representative McHugh,

We appreciate the opportunity to provide testimony for the Special Panel on Postal Reform & Oversight on the critical importance of postal reform to The Instant Web Companies and a $900 billion sector of the U.S. economy. IWCO is gravely concerned about the continued ability of the U.S. Postal Service to provide reliable and affordable universal mail delivery. IWCO is an integrated direct mail services company employing more than 1,000 people. The success of the Postal Service is of vital importance to our company. In 2003, IWCO presented more than 800 million pieces of mail to the Postal Service, accounting for more than $154 million in postage revenue.

Over the past six weeks, we have met with Minnesota's legislators to discuss the importance of this issue to their constituents in Minnesota and to the nation. Congressman John Kline toured our facility earlier this month. He saw first-hand the direct mail manufacturing industry and the 1,000 manufacturing, technical, professional and administrative jobs that will be impacted if the issue of postal reform is left unresolved. Congressman Kline is on record with your office, indicating his support to resolve the issue in an upcoming postal reform bill. Congressman Jim Oberstar has also indicated his support for postal reform. The time to address Postal Reform is now. The groundwork is in place:

- The US Postal Service issued its "Transformation Plan" in April 2002.
- The President's Commission on the US Postal Service issued recommendations on Postal Reform in July 2003.
- The Bush Administration has endorsed Principles for Postal Reform based on the Commission report and has called on Congress to enact comprehensive Postal Reform.

We commend the Special Panel on Postal Reform & Oversight for seriously addressing the need for Postal Reform. We consider the following to be key priorities in Postal Reform legislation:

Civil Service Retirement Funding:
Public Law 108-18, the Postal Civil Service Retirement Funding Reform Act of 2003, provided *short-term* relief to the Postal Service and postal ratepayers from the overfunding of CSRS pension obligations.

It helped prevent an immediate rate case and has provided a brief period of postal rate stability. Although this law was a good start toward postal reform and stability, modifications are urgently needed:

- Beginning in FY 2006, PL108-18 requires the Postal Service to escrow the difference between the corrected and uncorrected annual payment to the CSRS retirement fund. If these funds are placed in escrow, mailers and consumers will continue to pay rates that have been raised over the years in order to cover expenses that were grossly overstated. By allowing the Postal Service to use these funds to stabilize rates and address unfunded obligations for retiree health care benefits, Congress can free up billions of dollars annually to encourage greater consumer use of the mail channel and permit the mailing industry to make substantial contributions to both the Postal Service's ability to maintain universal service and stimulate the national economy.
- PL108-18 also requires the Postal Service to fund the pension costs for its employees attributable to military and volunteer service. The Postal Service is the only self-supporting federal agency required to pay these costs for its employees. *The obligation for military pensions should be a taxpayer responsibility, not a ratepayer responsibility.* By returning these obligations to the Department of Treasury where they belong, Congress can relieve the Postal Service from overcharging consumers (its customers) for obligations that rightly belong to the government as a whole.

Congress must act to prevent devastating rate increases. Without these changes, postage rates will be raised unnecessarily. The Postal Service will need to file for a rate increase of over 10% in FY 2006. A large rate increase would be devastating to the mailing industry and the overall economy, leading to job losses and possible business failures. The Postal Service itself would be harmed as higher rates lead to volume declines and a potential "death spiral" for the Service. Fortunately, it is possible to prevent large rate increases by addressing all of the pension and health benefit issues together as part of postal reform. Congress should take steps to correct all of these issues together for the sake of the Postal Service, its customers and the nation.

Enabling Greater Pricing Flexibility:
The Postal Service should be allowed greater flexibility in rate making in order to respond to the marketplace in a timely manner. It should be able to expeditiously adjust rates within set parameters to meet public demand for its products and services. The existing postal rate structure should be replaced with an incentive based structure predicated on activity based costing and keyed to the least costly of the functions the Postal Service performs. Features of a more flexible rate setting structure would include:

- Rate regulation limited to non-competitive products
- Pricing flexibility for these products within the framework of a price cap system
- Price cap adjustments and rate changes made no more frequently than annually
- Rates based on the costs of resources consumed through services provided.

Strengthening Regulatory Oversight and Transparency:
The Congress should establish a Postal Regulatory Board as described in the President's Commission Report. This body should have enhanced powers (compared to the current Postal Rate Commission) going beyond reviewing postage rates. The procedures by which this regulator reviews rates must be clarified to ensure that the system is fair *and* efficient. Features of a strengthened Postal Regulatory Board would include:

- Broad oversight authority to include service standards and financial transparency as well as rate regulation
- Expedited rate and complaint review processes

- Power to compel discovery
- Expanded Postal Service disclosure and reporting obligations.

We also call on the Special Panel on Postal Reform & Oversight to strongly encourage the Postal Service to accelerate their internal reform efforts in areas not requiring legislative action. The following are crucial areas for internal reform:

Rationalize the postal logistics network:
The Postal Service should move swiftly to realign its logistics networks to meet current demands – eliminating redundancy and excess capacity. This should include closing or consolidating facilities to the extent such actions do not substantially impair its ability to provide universal service. Although the President's Commission calls the Postal Service's network rationalization initiative its most "tangible and important deliverable," progress by the Postal Service toward this goal has been equivocal at best.

Maximize use of worksharing partnerships:
Worksharing partnerships between the Postal Service and the private sector have proven to be successful in advancing service and reducing costs, to the mutual benefit of the Postal Service and the mailing community. These partnerships have created incentives for businesses to prepare and present mail that is more efficient for the Postal Service to handle. These partnerships also provide mailers with a means to soften the impact of increasing postage costs, preventing the transfer of mail volumes to other media. The Postal Service should be encouraged to maintain and expand these relationships.

Transparency in financial cost reporting:
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.

Enactment of comprehensive Postal Reform legislation is critical to the continued success of The Instant Web Companies and the mailing industry as a whole. Lack of reform means only one thing: ***rapidly rising postage costs***! Postage increases that result in reduced mail volumes affecting paper companies, printers, envelope manufacturers and mailers – companies that provide nine million jobs, $900 billion in commerce and nine percent of the gross domestic product.

Congress has a unique opportunity to reform how postal services are provided in this country. We must allow the U.S. Postal Service to operate like a business – focusing on quality, affordable services and working with its customers to develop new and innovative products.

Kind regards,

James N. Andersen

Comments of Magazine Publishers of America
to the
House Government Reform Committee
Special Panel on Postal Reform and Oversight
February 11, 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 crucial and pressing need for postal reform legislation and the key elements necessary for meaningful and comprehensive reform. We commend you for your active engagement on this difficult and important public policy issue and your commitment to bring postal reform legislation to fruition this year. Your efforts at this critical juncture are key to ensuring a viable, affordable, reliable, and efficient Postal Service for the foreseeable future – a Postal Service that will continue to be the lifeblood of the $900 billion-a-year mailing industry and the cornerstone of a healthy U.S. economy.

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 our 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 Administration's commitment to reform of the nation's postal system. The Administration reinvigorated the postal reform process by establishing the President's Commission on the United States Postal Service. This Commission conducted a thorough analysis and careful review of the important issues currently facing the Postal Service and provided strong recommendations for the kind of postal reform that will help ensure the efficiency, affordability, and stability of the system for the coming decades. The President and his Administration continue to demonstrate their commitment to the reform process, issuing statements in support of comprehensive postal reform and articulating sound principles to guide the reform deliberations. With this strong base of support from the committee, your counterparts in the Senate, and the Administration and with key insights provided by the Postal Service, GAO, Treasury, the Postal Rate Commission, employee groups and mailers, we have a unique window of opportunity to achieve long-lasting postal reform.

As will no doubt be repeated by many of the witnesses appearing before this panel and committee, there are a number of key elements to achieving meaningful postal reform. These include the following:

Pricing Flexibility/Regulatory Oversight

- Pricing for postal products and services should be streamlined and modernized and rate predictability afforded to mailers by instituting a rate indexing system for market-dominant products.
- To drive costs from the postal system and attract new volume, the Postal Service needs additional pricing flexibility and tools such as negotiated service agreements and market tests.
- Given the continuing need for regulatory oversight, the scope of authority for the regulator should be clearly defined in postal reform legislation. This authority should include regulatory oversight of compliance with measurable service standards for all classes.

Cost Control/Improvements in Infrastructure and Labor Negotiations

- Efforts to rationalize the postal network should be encouraged and political constraints that impede plant closures and consolidations minimized.
- 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.

Universal Service/Public Policy Considerations

- The postal system should be maintained as a fundamental service for all Americans founded upon sound principles of public policy, including

continuation of time-honored preferences for favorable rates for the mailing of periodicals and non-profit correspondence.

- Policy determinations with regard to the Postal Service's universal service obligation and monopoly should be retained by Congress and not delegated to a regulatory body.

Civil Service Retirement Fund Payments

- The escrow requirement in P.L. 108-18 should be eliminated. If left in place, this requirement will result in a disastrous, double-digit rate increase in the next rate case.
- Responsibility for CSRS costs relating to the military service of Postal Service retirees should be returned to the U.S. Treasury.

We are pleased to provide additional comments on each of these critical reform issues.

Rate Indexing System

We 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. We recommend that this Committee include a requirement for a rate indexing system in any proposed postal reform legislation. To achieve the best balance between pricing flexibility for the Postal Service and rate protection for mailers, we recommend that such a rate indexing system be implemented at the mail subclass level.

The Commission proposed that the Postal Service be allowed to raise rates without prior review as long as the increase 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.

We would note, however, concern with one of the Commission recommendations with regard to price increases, a recommendation also reflected in previous legislative proposals before this committee. The Commission recommended 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 recommended 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.

Negotiated Service Agreements

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.

As with the rate indexing system, the provision for negotiated service agreements should include a streamlined process based upon a complaint-based review system. While NSAs are permitted under current law, the NSA process has proved to be cumbersome. If the flexibility for innovative agreements is to be meaningful, a much more facile system is needed.

Regulatory Authority

The President's Commission 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 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. As stated previously, we recommend that important

public policy determinations with regard to the Postal Service's universal service obligation and monopoly should be retained by Congress and not delegated to a regulatory body.

Network Rationalization

We agree with the President's Commission's conclusion 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.

Improvements in the Collective-Bargaining Process

We agree with the President's 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 can be improved.

As the Postmaster General testified before this Panel, 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 7). 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.

As the President's Commission also 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.

Universal Service/Public Policy Mission

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.

Civil Service Retirement System Overpayment

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.

* * * * * * * * * *

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. The need for postal reform legislation is urgent. With your strong and aggressive leadership, meaningful and comprehensive reform can be, and should be, enacted this year.

We hope that you find our perspective on the key elements of postal reform useful and look forward to continuing to work with you on this vitally important issue.

National Star Route Mail Contractors Association

Testimony Of

John V. "Skip" Maraney
Executive Director – February, 2004

Before the House Special Panel on
Postal Reform and Oversight

Honorable John M. McHugh, Chairman

Statement of
John V. "Skip" Maraney
Executive Director
National Star Route Mail Contractors Association

Mr. Chairman

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.

526 PAY ADJUSTMENTS

526.1 Basic Laws, Rulings, and Opinions

.11 Laws

.111 39 USC 6423, Readjustment of Compensation of Contractors and Mail Messengers

a. The Postmaster General with the consent of the contractor may readjust the compensation under a star route, contract motor vehicle service, or water route contract for increased or decreased costs occasioned by changed conditions occurring during the contract term which could not reasonably have been anticipated at the time---
   (1) The original bid was made; or
   (2) The bond for a renewed contract was executed as authorized by 39 USC, Section 6416.

b. The Postmaster General may readjust the compensation under an agreement for the performance of mail messenger service on account of increased or decreased costs occasioned by changed conditions which could not reasonably have been anticipated at the time the agreement was made.

.112 39 USC 6352, (b) (5) Highway Post Office Contracts

The Postmaster General, in contracts for highway post office service, may provide for the readjustment of compensation either upward or downward to reflect the service changes and increased or decreased costs attributable to changed conditions occurring during the contract term over which the Postmaster General or the contractor has no control and which could not reasonably have been foreseen at the time the original bid was made or the proposal for renewal filed.

Rulings and Opinions

.1[illegible] Comptroller General Ruling on Intent

Because of the broad language of the various statutes governing contract adjustments, the Postmaster General sought and received a ruling from the Comptroller General governing their application. The Comptroller General ruled that because the law did not define to what extent compensation might be adjusted, it was necessary to resort to the legislative history of the law to determine the intent of Congress. The legislative history, including committee reports and discussion, indicated that:

a. Adjustment of contract pay would be made when costs are increased or decreased because of changed conditions.
b. Changed conditions include increases and decreases in the cost of living, purchase or maintenance of equipment,

additions to or subtractions from route requirements, and increases or decreases in the volume of mail or services performed.
c. Contractors should not be forced into situations which require them to carry mail at a loss.
d. Contractors have a right to expect a return for their work which will permit them proper standards of living.
e. Extensions or revisions of contracts should take into consideration human elements enumerated in 526.121c and 526.121d.
f. When conditions change, the contractor has the right to ask for adjustment so he can make a profit, or at least a living, and break even or better.
g. The intent of the law is:
   (1) To eliminate insecurity.
   (2) To prevent "cutthroat" bidding.
   (3) To retain the services of honest and conscientious carriers.
   (4) To permit a flexible procedure for adjustment.
   (5) That the Postmaster General administer the law with the purpose of using it as a tool to eliminate the inequities existing in the star route system.
   (6) That the Postmaster General approach the problem of adjustments and renewals from a viewpoint sympathetic to the existing contractor.

.122 Comptroller General Ruling on Requests

The Comptroller General ruled that to allow an increase without a request by the contractor would constitute encouraging a claim against the Government. It is unlawful for a Government official to encourage such claim.

.123 General Counsel, Post Office Department, Opinions

a. When economic conditions change upward to a degree that increased wages are sought in private industry, contractors have a right to expect equal consideration.
b. The Post Office Department cannot allow a blanket increase either in percentage or dollars, because:
   (1) A blanket increase would be without request by the contractor as prohibited in 526.122.
   (2) The law is singular referring to "contractor" and "him."
   (3) Each case must be judged on its own individual merits.
   (4) Changes in conditions will have a varying impact on contractor's costs in different parts of the country. An arbitrary percentage or dollar increase might fail to adequately compensate a contractor in one area and over compensate another in another area or even in the same area.
c. Subcontractors are entitled to the same consideration as contractors.

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

B-141203

November 15, 1983

The Honorable Charles McC. Mathias, Jr.
Committee on Government Affairs
United States Senate

Dear Senator Mathias:

This responds to your letter of August 5, 1983 in which you ask about the legislative history of the Act of June 19, 1948, Pub. L. No. 80-669, 62 Stat. 477, originally codified at 31 U.S.C. § 434, and its relevance in interpreting 39 U.S.C. §§ 5005(a)(4), (b)(1) and (b)(2), the successor to section 434. The 1948 Act provided both for star-route contract renewals and readjustments upon mutual agreement of the Postmaster General and contract holder. Your staff suggested that your interest resulted from complaints that the Postal Service might award renewable contracts to persons other than the star-route contractor holding the original contract. For the reasons given below, we think the legislative history of the 1948 Act should be used to interpret the cited subsections of section 5005.

With respect to the questions asked, the Postal Service maintains that both the legislative history of the Acts referenced above and the substantial preservation of the Act of June 19, 1948 by the Postal Reorganization Act show that the Congress was satisfied that the earlier act struck a reasonable balance between the competing needs of the Postal Service and star-route carriers. In this regard, the Postal Service states that there never has been a vested right of a star-route contractor to renewal of a star-route when a Postal Service contracting officer determines that the public interest would best be served by opening up the route for competitive bidding.

The Act of June 19, 1948 provided in pertinent part:

> "The Postmaster General may, in his discretion and in the interest of the postal service, * * * by mutual agreement with the holder of any star-route contract, renew such contract at the rate prevailing at the end of the contract term, for additional terms of four years with such bond as may be required by the Postmaster General. Any such contract may be terminated at the end of any four-year term at the option of the Postmaster General or the contractor or terminated at any time by operation of any existing law.
>
> "The Postmaster General may, in his discretion and under such regulations as he may prescribe, with the consent of the contractor, * * * readjust the compensation of a star-route contractor for increased or decreased

costs occasioned by changed conditions occurring during the contract term which could not reasonably have been anticipated at the time of making his original proposal or executing his bond for a renewed contract as provided herein."

The Committee reports and floor debate show that the Act was intended to protect star-route contractors. H. Rep. No. 2003, 80th Cong. 1st Sess. 3 (1947); S. Rep. No. 279, 80th Cong. 1st Sess. 1-2 (1947); 94 Cong. Rec. 7101-07 (1948). The House report states that the legislation would "eliminate insecurity, prevent cut-throat bidding, retain the service of honest and conscientious star-route carriers and permit a flexible procedure for adjustment based upon changing economic conditions." H. Rep. No. 2003, supra, at 3. See also B-78175, March 6, 1950. The report also says that in instances where star-route contractors have performed their contracts satisfactorily "the Postmaster General should approach the problem of letting new contracts or making adjustments in existing contracts based upon changing economic conditions from a viewpoint sympathetic to the existing contract holder." Id.

The Act also intended flexibility in the renewal process. In interpreting the legislative history, the United States Court of Appeals for the Second Circuit stated that the Act was intended to maintain flexibility for the Postal Service by making the contract renewal decision a discretionary matter and that under the Act 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 (2d Cir. 1975). This position also was evidenced in the hearings on the Act. Thus, the Post Office Department's Director of Transportation pointed out that the Act would give the Postmaster General authority either to negotiate a follow-on contract with the same contractor on a job-source basis or to recompete, whichever might be most advantageous. Carrying of Mail on Star Routes: Hearings on S. 263 Before a Subcomm. of the Senate Comm. on Civil Sevice, 80th Cong., 1st Sess. 5 (1947). See also Star Routes: Hearings Before the House Committee on Post Office and Civil Service, 80th Cong., 1st Sess. 6 (1947) (Statement of Frank E. Russell, National President of the National Star Route Mail Carriers Association.)

In 1960, title 39 of the United States Code was enacted into positive law. Pub. L. No. 86-682, 74 Stat. 578. Former section 434 was repealed and restated as subsections (a) and (c) of section 6416 and subsection (a) of section 6423 of title 39 with minor changes in

phraseology. 1/ Public law 86-682 intended only to restate existing law: it did not make any substantive changes to the Act of June 19, 1948. H. Rep. No. 36, 86th Cong., 1st Sess. 3 (1959); S. Rep. No. 1763, 86th Cong., 2d Sess. 5 (1960).

Subsequently, title 39 was revised and reenacted by the Postal Reorganization Act, Pub. L. No. 91-375, 84 Stat. 719. That Act eliminated sections 6416 and 6423; however, similar language was incorporated into the new section 5005. In pertinent part, that section provides:

"§ 5005. Mail transportation

(a) The Postal Service may obtain mail transportation service—

* * * * *

1/ Those subsections state:

"§ 6416. Renewal of contracts

(a) The Postmaster General, by mutual agreement with the holder of a star-route, * * * and without advertising may renew the contract for successive terms, of not more than four years each, at the rate of compensation prevailing at the end of the preceding contract term. The contractor shall give such bond as the Postmaster General requires.

* * * * *

(c) A contract under this section may be terminated at the end of any four-year term at the option of the Postmaster General or the contractor, or at any time by operation of law."

* * * * *

"§ 6423. Readjustment of compensation of contractors and mail messengers

(a) The Postmaster General with the consent of the contractor may readjust the compensation under a star-route, * * * for increased or decreased costs occasioned by changed conditions occurring during the contract term which could not reasonably have been anticipated at the time—

(1) the original bid was made * * * ."

(4) by contract from any person (as defined in section 5201(7) of this title) or carrier for surface * * * transportation under such terms and conditions as it deems appropriate, subject to the provisions of this section.

(b)(1) Contracts for the transportation of mail procured under subsection (a)(4) of this section shall be for periods not in excess of 4 years (or where the Postal Service determines that special conditions or the use of special equipment warrants, not in excess of 6 years) and shall be entered into only after advertising a sufficient time previously for proposals. The Postal Service, 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.

(2) A contract under subsection (a)(4) of this section may be renewed at the existing rate by mutual agreement between the holder and the Postal Service."2/

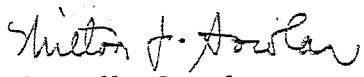
A comparison of the quoted subsections of section 5005 with its predecessors shows little substantive change. The new section continued the authority, upon the mutual agreement of the Postal Service and contract holder, to readjust compensation under a contract for increased or decreased costs and to renew a contract without advertising. Although the legislative history of the Postal Reorganization Act provides little specific discussion of the star-route program, it suggests that the new provision was substantially the same as its predecessors. See H. Rep. No. 1363, 91st Cong., 2d Sess. 83 (1970); S. Rep. No. 912, 91st Cong., 2d Sess. 20-21; 116 Cong. Rec. 26953 (1970) (Comment of Senator McGee, Chairman of Senate Comm. on Post Office and Civil Service).

2/ In 1972, subsection (b)(2) of section 5005 was amended by replacing the word "holder" with the phrase "contractor or subcontractor." Pub. L. No. 92-286, 86 Stat. 133. The purpose of the amendment was to extend the authority of the Postal Service to renew star-route contracts with subcontractors when a subcontractor was performing the service under the prime contract. H. Rep. No. 948, 92d Cong., 2d Sess. 1-2 (1972); S. Rep. No. 342, 92d Cong., 1st Sess. 1-2 (1971). No other change has been made to the section.

Both the United States Court of Appeals for the Second Circuit and this Office have taken the position that the sections are substantially the same. Thus, in Myers & Myers, Inc. v. United States Postal Service, 527 F.2d 1252, 1254n.2, 1257 (2d Cir. 1957), the court relied on the legislative history of the Act of June 19, 1948, to interpret subsection (a)(4) and (b)(2) of section 5005. And, as you point out, in B-141203, May 31, 1972, we concluded that under the Postal Reorganization Act, the Congress intended to give the Postal Service the same authority with respect to star-route contracts as the former Post Office Department had under the Act of June 19, 1948.

For the above reasons, we think the legislative history of the 1948 Act should be used to interpret subsections (a)(4), (b)(1) and (b)(2) of section 5005.

Sincerely yours,



Acting Comptroller General
of the United States

GENERAL LEAVE TO EXTEND

Mr. DONDERO. Mr. Speaker, I ask unanimous consent that all Members may have five legislative days in which to revise and extend their remarks on the bill.

The SPEAKER. Is there objection to the request of the gentleman from Michigan?

There was no objection.

FOREIGN-AID APPROPRIATION BILL, 1949

Mr. TABER, from the Committee on Appropriations, reported the bill (H. R. 6801) making appropriations for foreign aid for the period beginning April 3, 1948, and ending June 30, 1949, and for other purposes (Rept. No. 2173), which was read a first and second time, and with the accompanying papers, referred to the Committee of the Whole House on the State of the Union and ordered to be printed.

Mr. LUCAS reserved all points of order on the bill.

EXTENSION OF REMARKS

Mr. HAVENNER (at the request of Mr. BLAND) was given permission to extend his remarks in the Appendix of the RECORD and include extraneous matter.

STAR-ROUTE MAIL CONTRACTS

Mr. HALLECK. Mr. Speaker, I ask unanimous consent that for the Rules Committee I may call up House Resolution 522, providing for the consideration of the bill, S. 263, to provide for the carrying of mail on star routes, and for other purposes.

The Clerk read the title of the bill.

The SPEAKER. Is there objection to the request of the gentleman from Indiana?

There was no objection.

The Clerk read the resolution, as follows:

Resolved, That immediately upon the adoption of this resolution it shall be in order to move that the House resolve itself into the Committee of the Whole House on the State of the Union for consideration of the bill (S. 263) to provide for the carrying of mail on star routes, and for other purposes, and all points of order against said bill are hereby waived. That after general debate, which shall be confined to the bill and continue not to exceed 1 hour, to be equally divided and controlled by the chairman and ranking minority member of the Committee on Post Office and Civil Service, the bill shall be read for amendment under the 5-minute rule. It shall be in order to consider without the intervention of any point of order the substitute committee amendment recommended by the Committee on Post Office and Civil Service now in the bill, and such substitute for the purpose of amendment shall be considered under the 5-minute rule as an original bill. At the conclusion of the reading of the bill for amendment, the Committee shall rise and report the same to the House with such amendments as may have been adopted, and any member may demand a separate vote in the House on any of the amendments adopted in the Committee of the Whole to the bill or committee substitute. The previous question shall be considered as ordered on the bill and amendments thereto to final passage without intervening motion except one motion to recommit.

Mr. HALLECK. Mr. Speaker, I yield myself [illegible]

The SPEAKER. The gentleman from Indiana is recognized.

Mr. HALLECK. Mr. Speaker, this bill was reported by the Committee on Post Office and Civil Service and, among other things, pertains to the carrying of mail on star routes. Members of the committee are here to discuss the provisions of the bill itself. I have no further comment concerning it. I see the gentleman from Illinois (Mr. SABATH) is here. I yield him 30 minutes.

Mr. SABATH. Mr. Speaker, I was not here when the bill was called up for consideration because the Rules Committee was holding hearings on very important legislation.

However, I know something about this bill. I appreciate that some Members feel it is necessary for us to change our star-route system and eliminate the awarding of contracts to low bidders. This bill proposes to give the Postmaster General the right to award contracts not to the lowest bidder but to any bidder he may prefer. I know it has been stated that these star-route carriers have not made very much money. However, I think they are being much better compensated than the post-office clerks and the letter carriers in the large cities where the cost of living has and is going up so tremendously. Still we are holding up the bill to increase the wages of the postal workers, a bill that the country demands and urges that we pass in order to do something to relieve the unfortunate situation of a group of men who, beyond any doubt are the most patriotic and the harder-working men we have in the Government service. That bill is not being brought in here for consideration, but this bill, eliminating the protection that the Government has in letting contracts to the lowest bidders, and playing favorites, is called up for consideration. The measure plays favoritism with those who stand best with the powers that be regardless of what the increased cost may be. Personally, I tried to obtain some information on how much it will cost over present costs, but I was unable to obtain the information from those who testified before the Committee on Rules. I am under the impression that this will add an additional three to five million dollars to the cost of star-route service. I do not think there is any justification for it, except that some gentlemen are interested in some of these people who would like to get these contracts at their own price. In view of the ever-increasing cost of government I think that we should cease being reckless in our appropriations and in the passing of legislation that means an additional burden upon the taxpayers of our country.

Mr. Speaker, we also have had a bill pending for a long while that would to some extent reduce the deficit which exists in the Post Office Department. I refer to the bill to increase second-class mail rates. I wonder why it is not being brought in here for consideration, because it has been carefully drafted and the committee has given it a great deal of consideration. [illegible] I think we [illegible] $150,000,000. There is still another bill that should be considered instead of the one under consideration, but you gentlemen have the power, you have the majority, and the demands of the favorites are great and you will follow their wishes regardless of the cost of the Government and regardless of the fact that you have failed to bring in the bill giving promised wage increases to the deserving postal and other Government employees. Yet you have failed to bring in this bill increasing second-class rates which will reduce the deficit of the Post Office Department as I have stated by at least $150,000,000.

I know why you do not bring the bill in. It would perhaps affect some of the magazines that are friendly to you and that you have so much interest in, also it may affect some of the newspapers that are favorable to you, so you do not want to increase the cost of second-class mail.

Mr. HALLECK. Mr. Speaker, will the gentleman yield?

Mr. SABATH. I yield to the gentleman from Indiana.

Mr. HALLECK. The gentleman has referred to the deficit in the Post Office operations and its effect on the taxpayers, and he referred to a measure to increase the postal rates to overcome some of that deficit. Would the gentleman support such an increase as that—that is, an increase in the postal rates—if such a bill were brought in here?

Mr. SABATH. Yes; and especially on second-class-mail matter. You do not lose any money on first-class mail. I leave it to the chairman of the committee if I am not right when I say we are losing money on second-class-mail matter due to the fact that we are carrying millions of catalogs of mail-order houses, which cost a tremendous amount of money, and which you are interested in aiding. These catalogs, weighing 2 or 3 pounds, are sent at great cost to the Government. I do not think the mail-order houses need this relief or should continue to receive this advantage from the Government. They are making enough money (be way it is, there is no question about that.

Mr. HALLECK. Mr. Speaker, I have no further requests for time.

Mr. SABATH. Neither have I, Mr. Speaker.

Mr. HALLECK. Mr. Speaker, I move the previous question.

The previous question was ordered.

The SPEAKER. The question is on the resolution?

The resolution was agreed to.

A motion to reconsider was laid on the table.

Mr. REES. Mr. Speaker, I move that the House resolve itself into the Committee of the Whole House on the State of the Union for the consideration of the bill (S. 263) to provide for the carrying of mail on star routes, and for other purposes.

The motion was agreed to.

Accordingly the House resolved itself into the Committee of the Whole House on the State of the Union for the consideration of the bill S. 263, with Mr. [illegible] in the chair.

The Clerk read the [illegible]

By unanimous [illegible]

Mr. REES. Mr. Chairman, I yield myself 3 minutes.

Mr. Chairman, the purpose of this legislation is to correct certain evils that have grown up during the years with respect to star-route service. The evils might be described as insecurity and financial losses to the carriers, both of which have had a rather bad effect on the mail service as well as the morale of the carriers. In recent years every Congress has been plagued with the problem of the star-route carriers and all are agreed that something ought to be done, but the proper solution has been difficult to obtain.

I want to say right here that the distinguished gentleman from Tennessee [Mr. MURRAY], has spent a great deal of time and effort and energy in an attempt to deal with this problem. A bill was reported to the House in a previous Congress authored by the gentleman from Tennessee [Mr. MURRAY], but for some reason did not secure the approval of the House. So, we are here today with this bill recommended unanimously by our committee and reported by the gentleman from Tennessee [Mr. MURRAY]; it has been agreed upon and approved by the Post Office Department. It has also been approved by the legislative representative of the star-route carriers. I do not know of any objection to this legislation.

Mr. RICHARDS. Mr. Chairman, will the gentleman yield?

Mr. REES. I yield to the gentleman from South Carolina.

Mr. RICHARDS. What will be the situation if the provision in this bill [illegible] a situation where bids have already been submitted to the Post Office Department on a particular route in the United States, and presently under consideration?

Mr. REES. With respect to that, the bill says in substance that if the Postmaster General approves the man who has the present contract he may continue his contract. What we are trying to get rid of here is the cut-throat bidding, where one person has a contract in effect and wants to renew it, and somebody comes along and underbids him by a few dollars. Ordinarily the lowest bidder is the one who receives it, but suppose a man bids $10 or $25 per year less, we will say, under the present law the new bidder is expected to get the contract. Then frequently he is disappointed and asks to be relieved of his contract. We are trying to get away from that. Of course, if he has offered a substantial [illegible] lower and the Postmaster General thinks a substantial amount can be [illegible] with a contract should be approved, [illegible] the bill provides that the Postmaster General may [illegible] in effect if the [illegible] fair and the service satisfac- [illegible]

Mr. REES. I yield to the distinguished gentleman from North Carolina, who has taken a great deal of interest in this legislation.

Mr. DOUGHTON. Under the bill now being presented by the distinguished gentleman from Kansas, can the Postmaster General disregard the bids, if he cares to, and continue the contract now in effect under which the contractor is carrying the mail?

Mr. REES. That is correct. If a contract is in effect and the Postmaster General thinks the contract is fair, he can continue it even though someone else bids a lower price. The gentleman is correct.

Mr. DOUGHTON. He has the discretion to carry on the present contract?

Mr. REES. That is right.

Mr. DOUGHTON. He would have no way of compelling the contractor to continue the contract unless he wanted it?

Mr. REES. Certainly not. There must be mutual agreement for contract extensions and revisions.

Mr. DOUGHTON. How about the bond? The present contractor is bonded only up to the 1st of July. The contractor would have to get a new bond; he could not extend the old bond?

Mr. REES. No; it is a new contract.

Mr. DOUGHTON. He would have to furnish a new bond?

Mr. REES. Yes; certainly.

Mr. DOUGHTON. If it is a new contract, for how long would it run?

Mr. REES. He [illegible] have a new contract for 4 years, just the same as what he has now.

Mr. DOUGHTON. If it is satisfactory to the Postmaster General and to the postmaster where the route originates, then he furnishes a new bond?

Mr. REES. Yes.

Mr. DOUGHTON. The contract would be renewed for 4 years?

Mr. REES. Yes.

Mr. DOUGHTON. I thank the gentleman.

Mr. RICHARDS. If the gentleman will yield further, the situation I was talking about was this. Suppose 3 or 4 months ago the Postmaster General called for bids on a star route and bond was put up by the bidders. Those bids are already with the Post Office Department, but the contract has not been let. Would this bill apply to the star routes where bids have already been submitted to the Post Office Department?

Mr. REES. I would say so, because the contract has not been let. If the present contractor has bid again, he will be given consideration for continuing his contract.

Mr. COLE of New York. Mr. Chairman, will the gentleman yield?

Mr. REES. I yield to the gentleman from New York.

Mr. COLE of New York. What happens in the event the contractor and the Postmaster General cannot come to an agreement as to the terms of the contract?

Mr. REES. [illegible] only seems they [illegible]

Mr. COLE of New York. Suppose they cannot agree.

Mr. REES. Then it is open for bids.

Mr. COLE of New York. Then the Postmaster General must accept the lowest bid?

Mr. REES. Yes; the lowest reasonable bid.

Mr. COLE of New York. That puts him right back in the situation the bill seeks to avoid.

Mr. REES. We must keep in mind we have given the present holder an alternative. He is throwing it open to bidding only because he wants a much more favorable deal.

Mr. BONNER. Mr. Chairman, will the gentleman yield?

Mr. REES. I yield.

Mr. BONNER. My understanding is that the Postmaster General has authority to accept the responsible bidder and not necessarily the lowest bidder.

Mr. REES. Certainly, that is correct. He has authority to accept the responsible bidder. He does not have to accept an irresponsible bidder, and I do not believe that he would.

Mr. BONNER. In other words, in the situation of the contract of a star carrier having expired and bids having been placed and opened, the Postmaster General under this bill, should it become law, can then negotiate with the existing carrier, he having given satisfactory service, notwithstanding the fact that there is a lower bidder.

Mr. REES. That is correct. The gentleman has stated the situation correctly.

Mr. BONNER. I congratulate the gentleman and his committee on this legislation. I think it is long past due.

I would like to ask the gentleman one further question. Does this place the star carrier in a civil-service status similar to that of the rural carrier?

Mr. REES. It does not.

Mr. BONNER. I regret very much that the legislation does not go that far, because I do think they are entitled to that, particularly those men who through the past years during the shortage of automobile transportation struggled and labored to carry on this service at a cost that did not return to them a fair amount for the operation of their vehicles.

Mr. REES. I appreciate the gentleman's views on that problem. I wish we had more time to discuss it here. I will say our committee did give the problem careful consideration.

Mr. DOUGHTON. Mr. Chairman, will the gentleman yield?

Mr. REES. I am glad to yield.

Mr. DOUGHTON. In renewing the present contract, could they renew it at a higher rate than at present? Suppose the contract was at a certain rate, would the Postmaster General have a right to renew that contract and increase the rate? If there were a new bidder who bid less, what would be the status then? I understand that the Postmaster General could renew it at the present price.

Mr. REES. That is right. The Postmaster General may renew the contract at an increased rate but must justify it [illegible]

Mr. REES. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield to the chairman of our committee the gentleman from Kansas.

Mr. REES. To clarify some of the discussion with respect to these bids, the gentleman from North Carolina called attention to the question of having a chance to compete. I will say this to him, that of the 2,264 star routes in the southern section, section No. 2, there are now 559 present holders that did not submit new bids. That is more than one-fourth of them. So, I just wanted to explain that the bidding is not a closed matter. Five hundred and fifty-nine routes are still open for bids that the veterans can bid on or anybody else. I just wanted to clarify that particular point.

Mr. COOLEY. Does the gentleman agree that in most of these cases, a majority of them, competitive bidding will be a thing of the past if you enact this law?

Mr. REES. I would not say that that would be true, not necessarily; no. I think the gentleman from Tennessee has made a very fair explanation on that score, so we hope there will be no cut-throat bidding.

Mr. MURRAY of Tennessee. I do not agree with the statement of the gentleman from North Carolina that this will destroy open competitive bidding. It only provides that in the event of faithful service performed by a star-route contractor that his contract will be extended for an additional term of 4 years. Many of the star-route contractors are old in the service, and it is not contemplated that they will be in the service many more years, and when they give up their service, their routes will go back to open competitive bidding.

Mr. COOLEY. I do not know that I object to the bill, but I did want to point out the fact that it is a possibility that for a few years in the future competitive bidding will become a thing of the past, because it will be a negotiation between the contractor and the Department.

Mr. MURRAY of Tennessee. That is true on certain routes. I agree with the gentleman from North Carolina.

Mr. DOUGHTON. If the gentleman will yield further, leaving out of consideration for the moment the present contractors who have not submitted new bids and do not desire to carry the mail any longer, the present contracts in the southern territory expire on the 30th of this month. Other bids have been submitted for all the routes. Will they be let under the present law or will the Postmaster General have the discretion to differentiate among those bidders, or will he have to take the lowest responsible bid among the new bidders?

Mr. MURRAY of Tennessee. The star-route contract in the South may be extended by the Postmaster General where the contractor has rendered faithful service and where the contractor wants to continue service, but if the contractor does not want the route any longer or does not bid, then the bids that have already been made and are now with the Post Office Department will be considered, and the contract for that route will be let to the lowest responsible bidder.

Mr. DOUGHTON. As under the present law?

Mr. MURRAY of Tennessee. That is correct.

Mr. DOUGHTON. I thank the gentleman.

Mr. MURRAY of Tennessee. This bill does not interfere with the present law providing for open competitive bidding. Under the present law, every star-route contract extends for only 4 years. At the end of 4 years the route must be put up for open competitive bidding. This bill amends the present law only in this instance: It gives the Postmaster General the right to extend the contract for additional terms of 4 years where the contractor wants the contract extended and where his services have been satisfactory to the Postmaster General.

Mr. DOUGHTON. It deals only with present contractors.

Mr. MURRAY of Tennessee. The gentleman is correct.

Mr. LYLE. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield to the gentleman from Texas, a member of our committee.

Mr. LYLE. I think it might be made clear here that for 3½ years the gentleman and I have worked on this matter. As a member of the committee, I think that what I wanted to get away from as far as possible, even more than the gentleman, perhaps, was cutthroat competitive bidding. I think it is no more sound to have cutthroat competitive bidding for star routes than it would be to have such bidding for mail routes in the city of Washington or in Corpus Christi or in any other place. The important thing is to have a sound, useful star route service. We cannot have that if men are carrying mail on these routes on a cutthroat basis, where they are losing money by the day, complaining constantly to the Department, and trying either to get out of their contracts or forfeit their bonds or negotiate through their Congressmen for higher pay. As for myself, I think that the further we get away from this unsound business of cutthroat bidding the better off the service in the United States will be.

Mr. MURRAY of Tennessee. I agree thoroughly with the statement of the gentleman from Texas. In many cases there has developed a vicious cutthroat system of bidding on the star routes. Take the case of a star-route contractor who has performed satisfactory service for five contract terms, covering 20 years, and his contract is again put up for bid for another 4 years, at the expiration of his fifth term. Everybody in the community where this star-route contractor operates knows what his contract pay was. Let us say his contract was $2,000 per year for the previous 4-year term. Some fellow who is out of a job in that community might say, "Bill Jones, the present star-route contractor is getting $2,000 a year—I am out of a job and I can bid that route for $1,995." By bidding $5 under the responsible contractor he would get the contract from the Post Office Department. We want to eliminate that.

Mr. LANHAM. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield.

Mr. LANHAM. There is one point that is not quite clear in my mind. Where bids have already been received, if this bill is passed can the Postmaster General renegotiate with the old carrier, or will he have to accept the lowest bid, since they have already been called for and received?

Mr. MURRAY of Tennessee. No, the Postmaster General can go ahead under the terms of this bill and extend for another term of 4 years the contract of any responsible, satisfactory star-route contractor, regardless of the bids that have been submitted.

Mr. LANHAM. I thank the gentleman.

Mr. MURRAY of Tennessee. In case no bids have been submitted or the present contractor has not submitted a bid, as is the case in about one-fourth of the southern contracts, then those contracts will be let to the lowest responsible bidders who have sent their bids down to the Post Office Department.

Mr. RICHARDS. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield.

Mr. RICHARDS. I believe you have a good bill here. The purpose of my question was to clarify the situation that has arisen in the southern districts to which this bill relates.

Mr. MURRAY of Tennessee. May I say to the gentleman that the members of our committee have labored long on this proposition. We have given it much study. We have tried to be fair to both the star-route contractors and to the Government. This bill does not satisfy the star-route contractors altogether. They want to be blanketed into the Civil Service and become Government employees. We just did not feel that we could go that far, but we did feel that where a contractor has rendered faithful service, the Postmaster General should have the authority to extend his contract for another 4-year term and free that contractor from the evils of cutthroat bidding.

Mr. LYLE. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield.

Mr. LYLE. Also there is another point. We came to the conclusion that it would be perhaps a great harm to the veterans themselves to make it possible for them to be getting $1,500 or $1,900 to carry a route that would cost them $2,200 or $2,300 under the present unbusinesslike method of bidding. We felt that this would do more justice to those veterans than to throw it completely open.

Mr. MURRAY of Tennessee. That is correct. You cannot have one yardstick for the payment of all star-route contractors, because there are eight different types of service performed by the different star-route contractors.

Mr. COOLEY. Mr. Chairman, will the gentleman yield?

Mr. COOLEY. I would just like to ask the gentleman if any veterans' organization appeared before the gentleman's committee in opposition to this measure?

Mr. MURRAY of Tennessee. No, sir. Certain veterans' organizations indicated that it would not meet with their approval for these star-route contractors to be blanketed into the Civil Service and not give the veterans a chance to bid when the star route contracts came up for competitive bidding.

Mr. COOLEY. That provision is not in the bill before us at the present time; is that correct?

Mr. MURRAY of Tennessee. That is correct. As I have stated previously, this legislation has the unanimous support of the committee. It is satisfactory to the Post Office Department. It is unobjectionable to the star-route contractors. Mr. Frank E. Russell, representative of the star-route contractors, appeared before the subcommittee considering this bill, and said that it was unobjectionable. It was not all that he wanted, but he certainly would like to see it passed on account of the time element involved. Your committee feels that this is a meritorious and deserving piece of legislation. We trust there will be no opposition to it.

Mr. REES. Mr. Chairman, I yield 4 minutes to the gentleman from Illinois [Mr. VURSELL].

Mr. VURSELL. Mr. Chairman, this star-route problem has been before the members of the Post Office Committee and the Civil Service Committee for the past 7 or 8 years. Eleven thousand men would like to come under civil service. The Senate voted to put them under civil service and sent us a bill which would cost some $15,000,000.

The facts are that the type of service, starting probably with a Ford automobile and finishing up with a man on horseback, and then, when he cannot go any farther with the horse, he goes through the mountains down in Kentucky and Tennessee on foot seems to make it impracticable to put these men under civil service. The Postmaster General says the administration of the bill under civil service would be next to impossible.

We must put a little faith in the Postmaster General. We have a Postmaster General who has come up from the ranks. He insists he can and will fairly deal with the employees and the Government. We ought to try to get rid of this problem and pass this legislation that will be fair to everyone, and in order to continue this service and give the best possible service to the patrons, we must put a little trust in the Postmaster General. We questioned him about this bill to be certain that there would be no politics in these appointments, and, we have confidence that it will be good for the Government and give the greatest security to those employees of the Government as well.

The star-route carriers preferred to be brought under civil service, but they have agreed to this bill because they feel that it will improve their present position. [illegible]

Now, we ask you to put a little confidence in the Postmaster General, that he will administer this bill properly, taking into consideration not only the interest of the carrier but of the general public. If he seeks to abuse the power granted in this bill, he can be checked by the Appropriations Committee, and he is certainly under the gun of the Civil Service Committee and can be checked by that committee. So you have nothing to fear. We ask you to put a little confidence in the committee, which studied this bill, which consists of only three or four paragraphs, and which found there was no objection from any quarter.

I would like to see this bill passed by a unanimous vote, because the bill ought to be enacted into law by this House and the Senate and signed by the President before this session closes. This is a good bill. There is no use asking a lot of questions about it. No question can be asked about this bill but what can be satisfactorily explained to an impartial mind. I hope the House will pass this bill by unanimous vote. I assure the gentleman from North Carolina [Mr. COOLEY] that the interests of the American Legion, Veterans of Foreign Wars, and various organizations, does not obtain as to this bill, but they would have an interest if you put them under civil service and attempted to blanket these 11,000 people into civil service without giving the veterans a chance. But there is no objection, as far as any veterans' organization is concerned.

For your further information, I think it is fair to say that probably 50 or 60 percent of the star route carriers are poor old World War I veterans, who, because of age, probably could hardly make a living in other walks of life. Many of them are making a good living on star routes and they are entitled to be protected from present cut-throat contracts. This is a veteran's bill, because it helps to protect the decent rights of these World War I veterans, who are now rendering faithful service to this Government. This legislation will help most all star route carriers, and in part will do justice to these faithful public servants.

The CHAIRMAN. The time of the gentleman from Illinois [Mr. VURSELL] has expired.

Mr. REES. Mr. Chairman, I yield 4 minutes to the gentleman from Minnesota [Mr. HAGEN].

Mr. HAGEN. Mr. Chairman, I introduced a bill somewhat similar to others that have been introduced on this problem as long ago as 6 years. I have been a member of this committee, with the gentleman from Tennessee [Mr. MURRAY] for 6 years. As he has told you, we have often considered star-route legislation, but until this year we were not able to get together on a satisfactory solution. I believe that this is a satisfactory solution to the problem, but if it is not just what we expect it to be, we can change it in a year or two.

However, this proposal should be given a fair trial. The committee was [illegible] the measure [illegible]

lem. You will be interested in knowing that out of 11,000 star routes, 5,500 have failed in the last 4 years. In other words, there is a casualty list of almost 50 percent in the contract holders during the last 4-year period. Every time there was a contract failure the Department had to call for new bids, and that takes time and money. Meantime the mail service suffers to the patrons on the route. So by this method we hope to eliminate the failures and defaults on star routes. Furthermore, it is pointed out in the report and as you will notice in the bill, that the change in the contract, the increase or decrease in the compensation must be agreeable to the present contractor; in other words, any proposals or suggestions made by the Postmaster General or the Department must be agreeable to the contract holder. If he is not satisfied he does not have to continue the contract or accept it. If the Postmaster General offers to give him an increase that he thinks is not sufficient he does not have to continue the contract. At the present time he has the privilege of giving up the contract and he will have that right under this bill. Where conditions change, the cost of cars goes up, the cost of living goes up, or the route is extended, or more mail is carried, he has the opportunity and the right to ask for readjustment of his contract so he can make a profit or at least a living and break even or better as they have not been able to do in so many cases in recent years. Just this bill and the Post Office Department will be able to operate its star route service more economically and more efficiently and without injustice to veterans of the First and Second World Wars who now hold contracts but who all too frequently in the past have found themselves losing the contract because of a bid $5 or $10 lower each 4 years. Then they find themselves left with a lot of expensive equipment on their hands for which they have no use. I can tell you about hundreds of cases where contract holders have lost their contracts because of a slightly lower bid by someone else after having held the contract for 20 or 25 years. They lost their contracts because of the vicious system of competitive bidding practiced over the past years. That is the system we want to eliminate and that is what we do to a great extent in this legislation.

Mr. BISHOP. Mr. Chairman, will the gentleman yield?

Mr. HAGEN. I yield.

Mr. BISHOP. I wish to call the committee's attention to a case down my way where a local boy, one of my constituents, lost a contract because he was underbid 50 cents. The Department gave the contract to a new bidder, because the new bidder underbid the contractor by 50 cents. This man was left with more than $8,000 of equipment on his hands, equipment for which he had no use and which he could not sell to the new bidder. It was a great loss to him. I think the problem raised by this bill should be given every consideration.

Mr. HAGEN. It is just [illegible]

correct and that is one good reason why the committee reported out this legislation unanimously.

The CHAIRMAN. The time of the gentleman from Minnesota has expired.

Mr. MURRAY of Tennessee. Mr. Chairman, I yield 3 minutes to the gentleman from Texas [Mr. LYLE].

Mr. LYLE. Mr. Chairman, you might say this to your constituents, that in no other instance that I have seen since I have been in Congress has a committee been able to work out a bill more nearly to the satisfaction of the Government and the people involved than the Committee on the Post Office and Civil Service in this star-route legislation.

There is a great deal of confusion as to what star routes are. I think I spent 2 years on the committee before I ever was able fully to inform myself on what a star route is. I highly commend to the Members of this House the various hearings that have been held so that they too may understand fully the difficulties that arose in working out a measure of this nature.

There are two things involved in a bill of this character: First, satisfactory service to the Government of the United States; second, satisfactory treatment to the people who serve the Government of the United States. We sincerely believe that this measure will serve both the country and those who carry the star routes.

Considerable thought was given to the proposition of blanketing all of these people into the civil service. It has some merit. Perhaps it has a great deal of merit. However, it is startling to contemplate the confusion that would arise in the department if you attempted to do that. Secondly, it would cost a great deal more money than I believe this House would want to spend at this time; and, third, it would upset the balance between the pay and the work of the regular rural-route carriers and the star-route contractors. Star routes have been carried by busses or other contractors of that nature, common carriers. Quite often they take on the nature of a rural route, but they are so varied that it is quite impossible to bring out a measure that intelligently can put the proper coordination over the whole field; consequently, I believe you will find that your people who are interested in star routes will be quite happy with this measure because it offers them some security that they do not have now. It offers them I think possibilities for better compensation. I can think of nothing that would do me more harm as a veteran than to require me to render a service to my country at a loss, and that is exactly what has happened in connection with many of these star-route carriers. It would be a great injustice to continue the present system.

Mr. Chairman, this legislation is long overdue. I know it cannot possibly meet the full approval of all concerned; however, may I call attention to the fact that very few bills that have passed this House since I have been a Member were in a form that I would not have rewritten in some portion or left out in some portion. Perhaps it is a fortunate thing I do not write all of the legislation here.

Mr. Chairman, I hope the committee will give full approval to this measure.

Mr. MURRAY of Tennessee. Mr. Chairman, I yield 2 minutes to the gentleman from Texas [Mr. MAHON].

Mr. MAHON. Mr. Chairman, a number of years ago I introduced a bill in the interest of the star-route carriers of the Nation. These carriers represent a small group, but they are entitled to justice. There is no doubt but that they are the forgotten men of the postal service. However, throughout the years the Members of Congress who were advised on the subject have sought legislation to remedy a bad situation, but somehow or other it has not been possible to secure action up to now.

I want to commend this committee and its members, the gentleman from Tennessee [Mr. MURRAY], the gentleman from Texas [Mr. LYLE], the gentleman from Kansas [Mr. REES], the gentleman from Minnesota [Mr. HAGEN], the gentleman from Illinois [Mr. VYSELL], and the other members who are responsible for presenting this bill for a small group of people who have long waited for some measure of justice to be meted out to them. It may well be that this bill is not perfect, but it will enable the House and Senate to work out the most favorable solution that can be agreed upon at this time and will be the basis perhaps for legislation in the future. I know that those people who have waited so long for legislation on this subject, the star route carriers and their families, will be highly appreciative of the action of their Congress in taking up and passing the pending legislation at the present busy moment of this important session of the Congress. Again, I want to congratulate the committee on the good work it has done.

The CHAIRMAN. If there are no further requests for time, the Clerk will read the committee substitute for amendment.

The Clerk read as follows:

That section 3961 of the Revised Statutes, as amended (U. S. C., 1940 ed., title 39, sec. 434), is amended by adding at the end thereof the following:

"The Postmaster General may, in his discretion and in the interest of the postal service, notwithstanding the provisions of section 3949 of the Revised Statutes, as amended (U. S. C., 1940 ed., title 39, sec. 429), by mutual agreement with the holder of any star-route contract, renew such contract at the rate prevailing at the end of the contract term, for additional terms of 4 years with such bond as may be required by the Postmaster General. Any such contract may be terminated at the end of any 4-year term at the option of the Postmaster General or the contractor or terminated at any time by operation of any existing law.

"The Postmaster General may, in his discretion and under such regulations as he may prescribe, with the consent of the contractor, and without regard to the provisions of sections 3968 and 3961 of the Revised Statutes, as amended (U. S. C., 1940 ed., title 39, secs. 428 and 441), readjust the compensation of a star-route contractor for the remainder of deferred pay, resulting from changed conditions occurring during the contract term which could not reasonably have been anticipated at the time of making his original proposal or executing his bond for a renewed contract as provided herein."

The CHAIRMAN. The question is on the committee amendment.

The committee amendment was agreed to.

The CHAIRMAN. Under the rule, the Committee rises.

Accordingly the Committee rose; and the Speaker having resumed the chair, Mr. STEFAN, Chairman of the Committee of the Whole House on the State of the Union, reported that that Committee, having had under consideration the bill (S. 263) to provide for the carrying of mail on star routes, and for other purposes, pursuant to House Resolution 522, he reported the bill back to the House with an amendment adopted by the Committee of the Whole.

The SPEAKER. Under the rule, the previous question is ordered.

The question is on the amendment.

The amendment was agreed to.

The SPEAKER. The question is on the third reading of the bill.

The bill was ordered to be read a third time and was read the third time.

The SPEAKER. The question is on the passage of the bill.

The bill was passed.

Mr. REES. Mr. Speaker, I ask unanimous consent that all Members who so desire may extend their remarks in the RECORD at the close of the discussion on the bill just passed.

The SPEAKER. Is there objection to the request of the gentleman from Kansas?

There was no objection.

LEAVE OF ABSENCE

By unanimous consent (at the request of Mr. ARENDS) leave of absence was granted to Mr. KEARNEY, for 3 days, on account of official business.

APPOINTMENT OF PHYSICALLY HANDICAPPED TO POSITIONS IN THE CLASSIFIED CIVIL SERVICE

Mr. REES. Mr. Speaker, I call up the conference report on the bill (H. R. 4236) to amend the Civil Service Act to remove certain discrimination with respect to the appointment of persons having any physical handicap to positions in the classified civil service, and ask unanimous consent that the statement of the managers on the part of the House be read in lieu of the report.

The Clerk read the title of the bill.

The SPEAKER. Is there objection to the request of the gentleman from Kansas?

There was no objection.

The conference report and statement are as follows:

CONFERENCE REPORT

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H. R. 4236) to amend the Civil Service Act to remove certain discrimination with respect to the appointment of persons having any physical handicap to positions in the classified civil service, having [illegible]

by the contractor, due to the lengthening or shortening of the route, the increase in mail carried, and other changed conditions.

Mr. COOLEY. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield.

Mr. COOLEY. I do not so understand this bill. This bill indicates that the compensation might be changed if there were a change in conditions which could not have been reasonably anticipated.

Mr. MURRAY of Tennessee. That is correct. That means that at the end of the 4-year term and if the contract is extended for another period of 4 years by the Postmaster General conditions are changed due to additional cost of operation, due to the extension of the route, due to increase in the amount of mail being carried, then the Postmaster General may increase the compensation of the star-route contractor at any time during the new term of 4 years.

Mr. COOLEY. It could only be done for the new term of 4 years.

Mr. MURRAY of Tennessee. That is correct.

Mr. COOLEY. At the present time if a man is carrying a star route and is not being reasonably compensated and is carrying the mail at a very low rate, he cannot immediately increase that for the period of the ensuing 4 years?

Mr. MURRAY of Tennessee. No. That cannot be done under the present law. Under the present law, if a star-route contractor feels he is being underpaid under his contract price and he cannot afford to carry the mail any longer the Postmaster General cannot increase his pay but the contractor may, under an act passed by Congress in 1940, ask the Postmaster General to cancel his contract. He will forfeit 30 days pay if the Postmaster General cancels the contract. Then that route will be again put up to open, competitive bidding, and the old contractor, whose contract was canceled at his request, may offer a new bid.

Mr. COOLEY. What effect does this have on the rights of returned GI's to take examinations? It appears to me if we permit the Post Office Department to renegotiate these contracts, all the GI's might be excluded, because they cannot compete in an examination.

Mr. MURRAY of Tennessee. May I say that many of the old contractors are gradually giving up their contracts at the end of the 4-year term. When the southern section was advertised for bids, on 49 of these routes there were no bids at all. In such cases the Postmaster General must get out and make some kind of a temporary contract for the carrying of the mail where there are no bids because the mail must be carried regardless. Also whenever the Postmaster General does not desire to extend a contract because he does not think the service of the carrier has been satisfactory for the past 4 years, that route will again be put up to open, competitive bidding. When the star-route contractor has decided to retire or has decided he may not want another 4-year contract, then the route is put up for competitive bidding. For instance, in the southern [illegible] South out of 2,264 star routes there did not submit new bids. Under this law those 559 routes would then be let under open, competitive bidding to the lowest responsible bidder from bids already received by the Post Office Department.

Mr. COOLEY. In those cases which the gentleman has just mentioned, any GI who has been away from home in the Army or in the service of his country can submit a bid, but in numerous other cases you are going to give the Postmaster General the power to relet those contracts to the exclusion of all those GI's who will not have a chance to compete by submitting a competitive bid?

Mr. MURRAY of Tennessee. That could be done as long as the services of the present star-route contractor have been satisfactory and efficient.

Mr. COOLEY. Does the gentleman think that is in keeping with the policy of Congress to give these GI's every opportunity to secure Government jobs?

Mr. MURRAY of Tennessee. Certainly I do, when these routes are let by open, competitive bidding. I think when a star-route contractor has carried the mail for 20 to 25 years, has rendered a faithful, efficient service, it is unjust and unfair for him to be deprived of his contract for another 4-year term by cutthroat bidding. We have many cases today where a conscientious, honest, capable contractor, who has served as a carrier for 20 years, has lost his contract by an underbid of a dollar or two.

Mr. COOLEY. If you are going to do that as a policy, you should give the postmasters some power to offer an inducement to that competent, efficient carrier that the gentleman is talking about. Under this law he cannot increase his pay $1 a year. He cannot offer him an additional $100 to stay on.

Mr. MURRAY of Tennessee. Certainly he can.

Mr. COOLEY. Under this law could he increase the compensation of a present carrier?

Mr. MURRAY of Tennessee. Under this proposed bill, yes; when his contract is extended by the Postmaster General for another term of 4 years.

Mr. COOLEY. Only in the event of change of circumstances in the year.

Mr. MURRAY of Tennessee. That is correct.

Mr. COOLEY. He cannot do it as of the beginning of the contract.

Mr. MURRAY of Tennessee. He can do it at any time during the extension of a new 4-year term.

Mr. COOLEY. Right at the beginning?

Mr. MURRAY of Tennessee. For instance, let us say that there has been a star-route contractor who has rendered faithful service for a number of years, and it develops that during his past 4-year term he has been carrying the mail at a loss, then it is nothing but right and fair that the Postmaster General should increase his compensation so that he will at least get a fair return on his investment and his time for carrying the mail at any time after his contract is extended for another 4-year term.

Mr. COOLEY. And the fixing of the compensation is left entirely in the discretion [illegible]

Mr. MURRAY of Tennessee. That is correct, when the contract is extended for a 4-year period.

Mr. COOLEY. And he can then offer some inducement to the old carrier to remain in the service?

Mr. MURRAY of Tennessee. That is exactly the situation.

Mr. COOLEY. But it is a fact that the GI will not have a chance to compete.

Mr. MURRAY of Tennessee. Except where the contract expires, where the star-route contractor whose services have been satisfactory does not desire his contract again, then the route will be put up to open competitive bidding.

Mr. BONNER. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield to the gentleman from North Carolina.

Mr. BONNER. I would like to call the attention of my colleague from North Carolina to the fact that many of these contracts now are held by servicemen, men of the First World War, and if the record will be looked into I am sure it will be found that the same thing is true in other communities as it is in mine; that is that a majority of the routes are served by former World War I veterans, so this business about GI's not having a chance to compete is not true.

Mr. MURRAY of Tennessee. I think the statistics show that of the present star-route contractors about 40 percent of them are World War I veterans.

Mr. RICHARDS. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield.

Mr. RICHARDS. What worries me about this bill is this: In the southern division bids have been called for; is that true?

Mr. MURRAY of Tennessee. That is correct.

Mr. RICHARDS. And many bids have been submitted on the understanding that the contract would be let under the old basis. Now, many veterans have submitted these bids. I think we have got a fair bill here, but what I am worried about is whether or not those people who have gone ahead and submitted their bids under a misapprehension will be dealt with fairly.

Mr. MURRAY of Tennessee. I think so.

Mr. HAGEN. Mr. Chairman, will the gentleman yield?

Mr. MURRAY of Tennessee. I yield to the gentleman from Minnesota.

Mr. HAGEN. The gentleman will recall that we passed a resolution just a few weeks ago authorizing the Post Office Department not to accept these bids which were called for recently in the southern division, so they have that authority now to defer the awarding of the contracts in anticipation of the passage of this legislation. So, the bidders have known for some time that they will not be considered and, as a matter of fact, there are many carriers in the southern section who are veterans and who are anticipating this legislation in the hope that they can renew their contracts.

Mr. RICHARDS. But many of these bids have been submitted [illegible]

Calendar No. 913

Congress
Session } SENATE { Report
No. 91-912

POSTAL REORGANIZATION

June 3, 1970.—Ordered to be printed

McGee, from the Committee on Post Office and Civil Service, submitted the following

REPORT

[To accompany S. 3842]

together with

INDIVIDUAL AND SUPPLEMENTAL VIEWS

Committee on Post Office and Civil Service, to which was re- the bill (S. 3842) to improve and modernize the postal service to establish the United States Postal Service, having considered same, reports favorably thereon with an amendment and recom- that the bill (as amended) do pass.

Statement

provisions of S. 3842 result from one of the longest and most ive studies in the committee's history. After public hearings ding over 2 months, the committee has met in a continuing series rking sessions in which solutions, alternative solutions, and new aches have been tested in incisive discourse ranging across the scope of postal activities and postal problems.

addition to formal executive sessions, the chairman, the ranking ity member, other members, and staff have met repeatedly with Postmaster General, the Deputy Postmaster General, the General nsel, and other Department representatives to weigh the questions ther and to seek reasonable solutions. The bill as reported, repre- ng only the views of the committee, thus incorporates a substantial re of Administration recommendations, and, in toto, reflects the ittee's careful evaluation of the Department's position on each Matters have been consulted and heard. Employee organization s, having agreed to support postal reform, have presented their s on a variety of postal questions, including labor-management ns, for committee consideration.

Background information available to the committee has been valuable and helpful: from the views and findings appearing in the four-volume report of the President's Commission on Postal Organization to the expert testimony recorded in the printed hearings of the Senate and House committees, the necessity for postal reform has been convincingly documented. Definitive committee action was not taken, however, until ways could be devised to fit together the two indispensable components of lasting reorganization of the Post Office Department. The committee sought, and in this bill believes that it has found, a means of reconciling the strong committee conviction that the post office, however restructured, must be, first of all, responsive to the historic public need for, and reliance upon, a secure, swift, dependable, and inexpensive communications system; and the obvious requirement that postal management must now be given the unfettered authority and freedom it has been denied for years to maintain and operate an efficient service. The bill states as postal policy that the postal service "shall provide prompt, reliable, and efficient service to patrons in all areas and shall render public service in all communities. The costs of establishing and maintaining the postal service shall not be apportioned to impair the overall value of such service to the people."

The pattern of public concern over the postal service is symptomatic of graver disorders in the post office than are reflected in an occasional delayed letter or smashed parcel. In fact, the Department's record of reliability and speed of delivery has until recently compared favorably with that of any other nation, despite the complaints of patrons. But the volume of our mail is outstripping our population in rate of increase. The U.S. Post Office serves 6 percent of the world's population while delivering as much mail as all the other nations combined. We can expect volume to rise from the present 83 billion pieces a year to 110 billion pieces in 1977. Under the impact of increasing mail volume the Post Office, in trouble today, clearly cannot withstand under its present structure the stresses that will be soon imposed upon it.

The fact that the Department is able to carry its massive burden as handicapped as it is by an archaic organizational arrangement and inadequately equipped with a creaking physical plant 40 years out of date—is a tribute to the perseverance and loyalty of the rank and file postal employee. He now looks to Congress for better days.

The committee's inquiries and every responsible study show that the Postmaster General is blocked or undercut at every turn by the labyrinth of postal statutes echoing every postal concern, interest, and plan expressed by Congress over a 200-year period. Laws have changed laws and have added to the body of them so that, by accretion, they have multiplied, decade by decade, leaving the Postmaster General bound in his own house. Twist and turn as he may, he cannot function in the public interest as a responsible manager.

The committee in no way deprecates the system of checks and balances established in the law over the years to insure that public policy is determined by Congress shall be followed by the Postmaster General. But it has found that, by the process of accumulation, the laws controlling the governance of the Department have become excessive and restrictive and that it is not too soon for a complete break with the past.

Former Postmaster General Lawrence F. O'Brien, when he said that the Post Office was in a "race with catastrophe," pointed to the clear danger ahead. He called for postal reform that would release the Department's chief and let him work in the public interest. His problems, as a responsible Postmaster General, are summed up in his valuable 1967 colloquy with the chairman of the House Post Office Appropriations Subcommittee:

> Mr. STEED. General . . . would this be a fair summary: that at the present time, as the manager of the Post Office Department, you have no control over your workload, 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 your physical facilities, and you have only a limited control, at best, over the transportation facilities that you are compelled to use—all of which adds up to a staggering amount of "no control" in terms of the duties you have to perform.
>
> Mr. O'BRIEN. Mr. Chairman, I would have to generally agree with your premise . . . that is a staggering list of "no control." I don't know [whether] it has ever been put that succinctly to me. If it had been at an appropriate time, perhaps I wouldn't be sitting here.

The areas of "no control," tending to foster drift and to inhibit innovation and imagination in the management of the Post Office even under the leadership of strong Postmasters General, can be overcome by four provisions of S. 3842: (1) continuity of top management, (2) the authority to control postal revenue, (3) the authority to control costs, and (4) the authority to acquire funds outside the budget to modernize the postal plant.

S. 3842 is no halfway measure. Its objective is to establish a postal structure and a method of operating that will entrust the management of the U.S. postal service, within broad policy guidelines designed to protect the ordinary mailer, to responsible public officials whose authority derives from the President. The committee reports the bill with the reminder to present and future postal managers that the system will work only if the public interest is kept as the paramount criterion in every decision made. Congress, in its multiplicity of views and in the diversity of its concerns, is no longer the appropriate governing body for the postal service. But Congress has served the people well by protecting their interests over the years and by recognizing the reliance of grassroots America on the Post Office. In proposing to relinquish as much control as this bill would vest in the new Board of Governors of the U.S. Postal Service, the committee believes the intention of Congress should be clearly expressed: that postal management should follow, quite literally, the policy section of the bill which states, "The United States Postal Service shall be operated as a basic and fundamental service provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people."

The Committee Recommendation

The committee recommends enactment of a complete revision of title 39, United States Code, to provide: (1) that the executive authority of the Postal Service be vested in a Board of Governors, independent of ordinary legislative and executive supervision and control, composed of 15 members, including nine Governors appointed by the President and confirmed by the Senate; two voting members of the Board of Governors appointed by the Board of Governors to run the Postal Service; and four nonvoting members of the Board of Governors from the Congress; (2) that ratemaking and mail classification authority be vested primarily in a Postal Rate Commission, composed of five Commissioners appointed by the President and confirmed by the Senate, who shall be independent of the Board of Governors and shall recommend rates and mail classifications on the basis of general legislative criteria enacted by law; (3) that the Postal Service be authorized to borrow money outside of the normal budget system; and (4) that the Postal Service be given broad authority to transport mail by surface and air.

Postal Policy

The committee recommends the enactment of a new statement of postal policy as the basic and fundamental charter of the Postal Service:

That the Postal Service is in fact and shall be operated as a service to the American people, not as a business enterprise, designed to provide excellent postal service;

That the Postal Service achieve and maintain compensation for its employees comparable to that of the private sector of the U.S. economy;

That postal rates and costs be apportioned fairly and equitably among all users of the mail;

That letter mail be sealed against inspection and always be delivered with priority;

That transportation be modernized and designed to achieve the most expeditious delivery of mail possible; and

That postal facilities be designed to improve the service, to provide convenience for the public, and to have ready access to air and surface transportation facilities.

As a permanent ingredient of the new Postal Service, the committee recommends that in recognition of the losses incurred in maintaining such offices outside of metropolitan areas, the Congress shall appropriate annually a percentage of the annual operating costs of the Postal Service. The operating costs shall be calculated in accordance with provisions of the bill, and the percentage appropriated shall be (1) 15 percent of the costs so calculated, or (2) 10 percent of the amount appropriated to the Post Office Department for fiscal year 1971, plus capital improvement appropriations, whichever amount is the lesser. This subsidy would be based on the requirement that the Postal Service maintain high quality service in rural areas, small towns, and other places where post office and other governmental services provided by the Postal Service are not self-sustaining.

Organization of Postal Service

The committee recommends that all authority for operations be vested in the Board of Governors of the U.S. Postal Service. Nine of the members of the Board, who are Governors, shall be appointed by the President, with Senate confirmation, on a bipartisan basis. The Governors appoint a Postmaster General, who will be a voting member of the Board of Governors, and the Governors with the Postmaster General appoint a Deputy Postmaster General, who will also be a voting member of the Board of Governors. Four additional nonvoting members of the Board shall be Members of Congress—two Senators and two Representatives.

The Board of Governors shall have broad authority and shall not, except as specified, be subject to Federal laws dealing with contracts, property, the civil service system, the Budget and Accounting Act of 1921, apportionment of funds, and other laws which in most instances apply to Government agencies and functions. Among other powers, the Board may issue rules governing the Postal Service, provide for the collection and delivery of mail, establish postal rates and mail classification, establish postal facilities and services, investigate postal offenses, sell property, borrow money, hire and direct its employees, and take such other actions as it deems necessary and proper to operate the Postal Service.

Except for the powers specifically vested in the Governors themselves, as distinguished from the Board of Governors, the Governors may delegate their executive authority to the Postmaster General or such other officers or employees of the Postal Service as they wish. The power to decide on postal rates and mail classifications shall not be delegated, and the Postmaster General and the Deputy Postmaster General are not permitted to vote on those issues.

The committee recommends the administration's proposal for a Postal Service Advisory Council, consisting of representatives from postal labor unions, organized mail users, and the general public, which shall have the privilege of consulting with and giving advice to the Board of Governors.

Employee Relations

The committee recommends the enactment of the labor-management agreement made between the Post Office Department and the AFL-CIO postal unions in April 1970.

The committee recommends that upon the establishment of the U.S. Postal Service, all employees of the Post Office Department be transferred to the U.S. Postal Service. Employees who have competitive status under the Civil Service Act of 1883 shall automatically achieve career tenure under the postal career system, but thereafter the provisions of title 5, United States Code, relating to the competitive service shall not apply to officers and employees of the Postal Service. The Postal Service shall establish, pursuant to its collective bargaining agreements with postal labor unions and its programs developed for officers and employees not subject to such agreements, a system which will assure career development and protection of employment rights. The postal career service shall be a part of the "civil service" as

...ar term is defined in section 2101(1) of title 5—that is, appointi...
...sitions in the executive, legislative, or judicial branches of the Go...
...ment of the United States.

Veterans' preference shall apply to officers and employees in th...
...stal Service, but may in certain circumstances be subject to modifi...
...tion by labor-management agreements or programs developed fo...
...upervisory personnel. The committee recognizes the significant de...
...ure from the present status of preference eligibles which th...
...vision makes, but we believe that if collective bargaining is to work...
...must have the power to establish a seniority and retention syste...
...sed primarily on postal career service. Nothing in the provisions of...
...ction 1101 of the bill will prevent the Postal Service management...
...nd the labor unions who negotiate an agreement from retaining what...
...ar degree of preference for veterans they deem compatible with col...
...tive bargaining.

The committee recommends that employees of the Postal Servic...
...main as participants in the provisions of the Civil Service Retire...
...nt Act and that the Board of Governors pay into the retirement...
...nd the employee deductions, agency contributions, and any oth...
...ounts required or authorized to be paid into the fund for the co...
...f maintaining or administering the civil service retirement and di...
...bility fund for postal employees.

The committee also recommends that employees continue to be cov...
...d under the Federal Employees Compensation Act for work in...
...uries, unemployment compensation, reemployment rights for military...
...rsonnel, and cost-of-living differentials in Alaska, Hawaii, Puert...
...Rico, and the Virgin Islands.

The committee recommends that all officers and employees of th...
...ostal Service who have career tenure shall be eligible for promotion...
...r transfer to any position in the Postal Service or the executive branch...
...f the Government of the United States for which they are qualified...
...hough the postal career service system is not under the Civil Serv...
...Act, the Board of Governors and the Civil Service Commission...
...uld develop a program which specifically provides for transfer...
...ility between the systems.

The committee recommends that employees above the rank-and-fil...
...el and carrier levels of employment be paid in accordance with...
...licy established by the Board of Governors. Fringe benefits may be...
...veloped by the Board as it deems advisable, or such employees ha...
...continued under the fringe benefit programs offered employees o...
...e Government generally. In developing programs relating to pay...
...fringe benefits, and other characteristics of employment, the co...
...ttee recommends that organizations of employees above the ran...
...file level be given a right to participate directly in the planning...
...development of pay policies and schedules, fringe benefit pro...
...ms, and other programs applicable to their members.

The committee has weighed very carefully the difference betwe...
...rticipation" and "consultation" in the development of employee...
...rams for supervisory and administrative employees. For employ...
...who are truly a part of management of the Government, the ...
...that consultation is all that is either necessary or desirable ...
...some validity; but employees in the lower levels of supervis...
...ministration in the postal service are not sufficiently separ...
...the nature of employment of those whom they supervise to jus...
...from them some degree of active representation in the

...elopment of employment programs which affect and, in fact, con...
...l their livelihood. The supervisor on the workroom floor is an in...
...ral part of the postal delivery system. To deprive him of active
...ce through his chosen representatives in the development of pro...
...ms affecting him would be unfair to him and not in the best interest
...the postal service. The committee does not recommend a system of
...lective bargaining for supervisory personnel, postmasters or ad...
...inistrative employees in the headquarters or regional offices of the
...tal service, but we do define "participation" as meaning precisely
...—to have a share in planning and developing the programs.

The committee recognizes the legitimacy of the concern expressed by
...tal supervisors over the lack of an adequate differential between
...salaries of supervisors and those of craft employees who work
...der their direction. Although supervisors often share the working
...ditions of the rank-and-file employee, they are appointed for their
...alities of leadership and for their skill in a wide variety of postal
...rations. Among these skills is one which—when applied accurately
...consistently—saves the Post Office Department incalculable annual
...s. That skill is scheduling—the arriving at an accurate judgment,
each tour, of how much mail is on hand to be worked and how
...ny men should be called in to work it. Supervisory errors here lead,
the one hand, to excessive manpower on the workroom floor with
...ployees "on the clock" but doing no productive work; or, on the other
...d, more mail than the work force can handle, resulting in delayed
...d.

Supervisory responsibilities, the committee has found, are not ade...
...tely recognized in existing schedules. For example, a clerk in step
...of level 5 ($8,510 a year) makes more money than a supervisor
...tep 1 of level 7 ($8,098 a year), and almost as much as a supervisor
...tep 1 of level 6 ($8,956 a year).

This condition often causes a reluctance on the part of employees
...accept promotion to supervisory positions. Sometimes after 21 years
...service, a clerk or carrier promoted to supervisor receives a salary
...crease of less than 8 percent, and he is expected to give up preferred
...k hours, which he has earned through his years of service, for a less
...irable tour at night.

Former Assistant Postmaster General for Personnel Richard J.
...phy stated at several public hearings that the salary differential
...ween supervisors and craft employees was not great enough and
...there should be a minimum differential of at least 25 percent. The
...ppel Commission Report decried the problem.

The committee, not wishing to impose a binding statutory require-
...t concerning this matter upon the Board of Governors, neverthe-
...states its views that rectification of this imbalance ought to be a
...ter of early concern to the new managers of the postal service.

Collective Bargaining

The committee recommends the enactment of the collective bargain-
...agreement for rank-and-file employees signed by seven AFL–CIO
...ated postal unions, the President of the AFL–CIO, and the Post-
...er General. The system will provide for true collective bargaining
...all issues in the postal service. In the event of an impasse, a fact-
...ding board shall be appointed and, in the event of further inability
...ch agreement, binding arbitration shall be imposed.

The "Right-to-Work" Issue

The committee recognizes and appreciates the problems involved in enacting a collective bargaining system with teeth in it for postal employees. Except in the Tennessee Valley Authority and one or two other small Federal operations, true collective bargaining has never existed in the Federal service. For management to bargain with 750,000 postal employees on an individual basis is utterly impossible. Thus, from the viewpoint of both postal management, postal unions, and the best interest of the general public, the committee recommends that the chosen representatives of postal employees be the bargaining agent on wages and working conditions. This is a system and a right established by Federal law in the National Labor Relations Act applicable to all other significant craft and industrial employment in the United States, except that Federal employees shall continue to be prohibited from striking, the general system of collective bargaining as it exists in the private sector of the economy, under Federal law, shall be applicable to the postal service.

Section 14(b) of the Taft-Hartley Act, retaining the right of a State government to enact legislation against a union shop, is preserved.

If State law prohibits the union shop, no provision of this bill may be construed to authorize a union shop in that State. The bill provides that a union shop for postal employees can be authorized only as a result of collective bargaining in States whose laws allow it.

The Landrum-Griffin Act, on reporting and disclosure, is made applicable to postal unions.

Politics in the Postal Service

The committee recommends that political endorsement for any position making application for any position in the postal service be prohibited and that the President and the Board of Governors establish an appropriate and effective prohibition system, including penalties of suspension, removal, and permanent disqualification from the postal service. The committee does not believe that the specific enactment of a particular system of prohibition is in the best interest of the postal service because of changes which can best be handled by administrative action. The elimination of politics in the selection of postmasters, rural carriers, headquarters employees, Postmasters General, or any other officers or employees of the postal service is, in the last analysis, the moral and ethical responsibility of the President and the Board of Governors. Nothing but the desire to establish a truly nonpartisan postal service can prevent an influential Member of the Congress or an influential county chairman from attempting to prevail upon an influential officer of the postal service to appoint someone to a position. The committee simply, and hopefully, recommends that politics in the Post Office be abolished and authorizes the postal service to insure the fulfillment of that policy.

Long-Term Financing

The committee approves the administration's recommendation on long-term borrowing authority. Under the provisions of chapter 21 of this bill, the Board of Governors is authorized to borrow money either from the Secretary of Treasury or upon the open market in an amount not to exceed $10 billion outstanding in bonds at any one time. The language of the administration's recommendation would permit the board to use all of the money it borrows for any purpose whatsoever, subject to an annual limitation upon the net increase in debt of $1.5 billion for capital improvements and a $0.5 billion for operating expenses.

The committee is confident that those who assume the management of the Post Office will recognize the difficulties the Post Office will encounter in attempting to borrow money if its financial structure is not sound and its spending practices are not proven. The committee has approved the administration's recommendation but here cautions the board of Governors that if borrowed money is used to meet current operating expenses, lenders will charge a very high premium. Thus, the use of bond revenue for operating expenses should be restricted to the most unusual circumstances. The basic purpose in authorizing the sale of bonds by the postal service is to avoid the annual battle between the Post Office Department and the Bureau of the Budget, which notoriously results in limitations upon funds available to be appropriated, and the occasional restrictions imposed by the President upon Federal construction spending.

This year, the Tennessee Valley Authority, which has a 37-year history of successful operations in the generation of electric power, sold $100 million in bonds due in 1995 for capital improvements in the TVA system on the bond market at a cost to TVA of 8.9 percent. U.S. Government bonds of comparable maturity sold at the same time at 6.46 percent. Thus the electric power customers of the TVA will pay a premium of 2.43 percent because the TVA bonds are not Government-backed bonds. TVA bonds have a current rating of AAA on the bond market. The TVA enabling act requires the TVA to increase its rates to maintain a satisfactory reserve for the payment of all expenses including bonds; nonetheless, 8.99 percent is the current cost to TVA of borrowing money. In the case of TVA, the cost is absorbed directly by the distributors which purchase electricity from the Authority. The general public pays the cost of interest indirectly and only to the extent that it is passed on from the distributors.

The general public of the United States will pay the full difference between the cost of Government bonds and the cost of postal revenue bonds through postal rates. Because the Post Office has an absolute monopoly on the transmission of correspondence, there will be no alternative for the average American citizen who uses the mail, and who, with only rare exception, uses only letter mail.

Thus in approving the administration request on bonding authority, the committee expresses its very firm hope, as well as its caveat, to the Postal Service and the Board of Governors that they will give the

highest consideration to the public interest in the entire matter of selling bonds and using bond revenue.

The committee recommends that 10 percent of the debt service on postal revenue bonds be appropriated to the Postal Service by the Congress in recognition of the Congress' responsibility for and the public's investment in postal modernization.

Postal Ratemaking

1. Free classes of mail

The committee recommends that certain types of mail now carried free of cost to the sender be continued. Such mail includes mail sent by a former President, his widow, or the widow of a Member of Congress for 180 days following his death; mail matter for the blind, and mail matter sent under the Voting Rights Act of 1955. The committee also recommends that letter mail sent by military servicemen in a combat zone shall be carried at no cost to him. Other mail sent to or by military servicemen, under the provisions of the 1966 and 1967 Vietnam and European theater airlift acts, shall be continued to be carried at ordinary rates subject to reimbursement to the Postal Service by the Department of Defense. Official mail shall be continued under the present reimbursement-by-appropriation process.

2. Other preferential classes of mail

The committee recommends that all other preferences heretofore established by law for the mailing of any mail matter be abolished, but that the mailers be given a sufficient period of time to adjust to any impact caused by rate increases. Under existing law, first-class mail and fourth-class parcel post are the only classes of mail in which there is any legislative requirement at all that they pay their full cost. Although various accounting systems have been proposed by various groups, some of whom have from time to time prevailed upon current administrations to adopt their cost-accounting theories, the only fact which seems to endure since the establishment of the cost ascertainment system in 1926 is that no one agrees for very long, and no system works very well. Expert advice rendered the Committee on Post Office and Civil Service in 1966 and 1967 suggested that whatever deficiencies might be characteristic of the cost ascertainment system, the system is nonetheless reasonably successful as a fully allocated cost-ascertainment system, particularly in view of the magnitude of the problem in ascertaining the costs of more than 80 billion pieces of mail on a sample basis.

Newspapers, magazines and advertising materials sent by various classes of mailers have been given preferential treatment by Congress for many years. Until 1962, for instance, newspapers did not have to pay anything to be delivered in the county of their publication. Today they pay a minimum of one-fifth of a cent per piece. The third class is applicable to fundraising solicitations for any religious, educational, scientific, philanthropic, agricultural, labor, veterans, or fraternal organizations was originally established at 1 cent in 1928 and was not increased at all until 1968—40 years later, and then by four tenths of a cent.

In his testimony before the Committees on Post Office and Civil Service of the House of Representatives and the Senate, Postmaster General Winton M. Blount emphasized on several occasions that these

"public service rates" would not be disturbed by the Postal Service so long as Congress appropriated the difference between the regular rate and the preferential rate. In other words, matters of policy on preferential rates and preferential categories of mail could continue under congressional jurisdiction and supervision.

The committee disagrees with this basic position of the Postmaster General and is pleased that in endorsing some of the provisions of S. 3842, the Postmaster General appears to have at least accepted the committee's position on "public service" categories.

The reason for the committee's difference of viewpoint is twofold. In the first place, if postal rates and postal classification are going to be established on a basis of charging whatever the traffic will bear to a particular class of mail according to its ability to pay, or what kind of an increase it got last time, or its "social acceptability," then Congress is clearly better qualified to make such judgments than the Postal Service or any expert commission. Such purely political judgments are the province of Congress. But if rates and classifications are to be established on the basis of expert consideration of the overall value of the service provided and the allocation of costs on a scientific or quasi-scientific basis, then Congress should be removed entirely from the ratemaking and classification business. To enact a law which says that hereafter a particular class or type of mail or mailer will have to pay only that rate which the Congress enacts by law will guarantee (1) that the rate will probably be increased only at the rarest of intervals; and (2) that every time the Postal Service raises rates by administrative action, organized mail users will use every available inducement to persuade the Congress to include them within the preferential group. Thus, a subsidy, which today, in the view of the Postmaster General, amounts to $300 million a year (representing the revenue foregone on preferential mail compared to regular rate mail) would grow to a staggering amount in a relatively short period of time.

The very existence of preferential classes of mail creates a climate for the expansion of that class of mail. When a church, a fraternal group, a labor union, or a science club knows that it can mail a newsletter to its members at a postage cost of $2 per 1,000 copies, the incentive for producing such a newsletter is natural. The tremendous growth in the volume of second- and third-class mail for the nonprofit group between 1958 and 1969, as compared to the growth of identical kinds of mail by regular second- and third-class mailers, proves the point: for regular rate mailers the volume increased 41 percent for nonprofit mailers the increase was 156 percent.

The theoretical basis of the committee recommendation on mail classification is that except for military mail, voting rights mail, and a very limited amount of free mail, there should be no preferential rates set by Congress. All ordinary mailers should begin on the same footing. The Postal Rate Commission, established under chapter 37, has the full authority without limitation and subject only to the general guidelines and policy of the act to establish classes of mail subject to the approval of the Governors of the Postal Service. If the Commission in its assessment of the public interest determines that newsletters mailed by a church are, in fact, of such social benefit that they should pay less than a newsletter sent by the chamber of commerce, then the Commission is fully authorized to recommend a class recognizing that distinction and a rate in accordance with that preference. But in order

to achieve true postal reform, as almost every witness before the committee has pledged himself to do, postal rates of past, as they are reflected in the provisions relating to mail classification and postal rates, must be made subject to change.

Any mail or class of mail which under existing law pays a rate which is less than the rate established by the Postal Service in its first rate schedule shall be entitled to a period of adjustment to reach the rate prescribed. For any such regular rate second-, third- or fourth-class mail or mailer, the Board of Governors shall establish a schedule of rates designed to achieve the regular rate in 5 years; for any mail or mailer entitled to a preferential rate by law, the Board of Governors shall establish a rate schedule to reach the prescribed rate in 10 years.

For example, the regular rate for a phonograph record weighing no more than 1 pound, mailed by one of the many phonograph record clubs in America, is 12 cents. If the Postal Rate Commission determines that the proper rate for that type of mail is 15 cents, then the mailer would be entitled by law to a period of 5 years to reach the prescribed rate. In the case of a public library mailing the same phonograph record to a patron of the library, the present rate is 5 cents; and if the rate prescribed by the Commission were 10 cents, the library would be given a period of 10 years to reach the prescribed rate.

This "grandfather clause" is designed to provide adequate protection to any class of mailers or type of mail which has been established, for whatever reason, as preferred groups, or which because of the existing rate structure, do not in fact pay the fair and equitable rate as determined by the Commission.

In the final days of its consideration of S. 3613, the committee considered but did not approve language which would have continued preferred rates for certain classes of mail. The committee preferred to preserve the integrity of its recommendations to the Senate on mail classification and not to establish by law any special rates which would be binding on the independent Rate Commission or would violate the provisions of the "grandfather clause."

Notwithstanding its rejection of a proposal to impose its views on the new Postal Service by law, the committee agreed that this report should specifically express committee concern over the rates to be established for certain classes of mail. Accordingly, the committee charges the Rate Commission established by this bill to the public service which certain preferred rates have historically performed.

Reduced rates for within-county newspapers, for libraries, for blind and for associations of rural electrification co-ops were enacted for very good reason—that the public generally benefits from such rates. Additionally, the Rate Commission should take into account the preferential rates for the mailings of authorized nonprofit organizations—religious, educational, scientific, philanthropic, agricultural, and labor mailings; and the rates for classroom publications, which are religious, educational, and scientific materials designed for use in school classrooms or in religious-instruction classes.

Of importance are agricultural publications devoted to promoting the science of farming and mailed in the first and second postal zones and other preferential rates.

The committee does not believe that small incremental increases in rates spread out over 5- and 10-year periods will be detrimental to mail matter allowed preferential rates because they contribute to the public welfare. But the Rate Commission should be aware of this special problem as it assembles its schedules of rates and fees.

The Postal Rate Commission

The President shall appoint a bipartisan Postal Rate Commission, with Commissioner to serve for 6 years. The Rate Commissioners shall be independent of the Board of Governors. They shall appoint their own staff and conduct their own business, subject to the Administrative Procedures Act, as they wish. The committee envisions the Commission to be an integral part of the postal service, to be a true partner of the Board of Governors in every aspect of postal operations. If a bureaucratic struggle between the Board and the Commissioners develops, then the whole theory of independent ratemaking judgments will have failed and the Congress will probably be called upon to revise the system. But if the individuals appointed to the board on the one hand, and the Commission on the other, recognize the constitutional and legal responsibilities of their position and work together to achieve a truly effective postal service, then the independence of the Commission will serve a vitally important function by permitting them to view the overall impact of postal costs with a degree of detachment which the committee considers vitally important to preserve the public interest and public investment in the largest civilian agency of the Federal Government.

The committee believes that if the Board of Governors were authorized to control revenues, it would place them in a position of some businesses in the private sector of the economy—pricing with one eye over their shoulder to the effect of the cost of an upcoming labor-management agreement.

The recent proposal for a 10-cent first-class stamp in order to raise sufficient revenue to balance the books of the Post Office in one single step is fair proof of that quest for catching up with costs. Most of the money in the postal system comes from first-class mail. A 100-percent increase in the rates for all second-class mail would not produce as much revenue as a 5-percent increase in the first-class rate. The temptation to resolve the financial problems of the Post Office by charging the lion's share of all operational costs to first class is strong; that's where the big money is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management.

The bill provides that the Postal Rate Commission shall be a body fully independent of the Board of Governors and fully independent of any influence whatsoever of the Postmaster General or of members of his staff. The Commission's independence is contemplated as being complete from the other arms of the postal service, subject to no subordination within the postal service either expressed or implied. The limited circumstances under which a recommended rate decision made by the Commission may be modified by the Governors are carefully spelled out in the language of the bill.

It is expected that the Commission will work in harmony with the Board of Governors, acting in a timely and responsive manner to the Board's requests for recommended decisions for changes in rates, fees and classifications.

In discharging the highly important responsibilities vested in the Commission, it must exercise its best judgment to insure that all postal rates, fees, and classifications are reasonable and equitable, and to insure that the rights of all mail users are protected, throughout the rate-making and classification process, by careful consideration of all the specific public-interest factors that the statute requires be taken into account, and by faithful adherence to all of the ratemaking and classification standards set forth in the statute.

The ratemaking cycle begins with a determination by the Board of Governors of the estimated costs and income of the postal service, with various adjustments that are required under section 3703 of the bill. These adjustments may be summarized as follows:

1. Starting with the estimated total costs for the period, including a reasonable reserve for contingencies, the Board must first deduct the lesser of $100 million or an amount equal to 10 percent of the annual debt service on notes, bonds, debentures, mortgages, and other debt instruments issued by the postal service. (The phrase "annual debt service" covers the amount of money required each year to amortize the principal amount of the indebtedness of the postal service, amortize any attendant debit discount and expense, and cover the interest cost on outstanding obligations; subject to a ceiling of $100 million. Section 2501(b) (2) authorizes an annual congressional appropriation equal to 10 percent of the annual debt service as so defined.)

2. The resultant figure must then be further reduced by an amount equal to the lesser of 10 percent of it or 10 percent of that portion of the Post Office Department's fiscal year 1971 appropriation not appropriated for capital improvements. (The amount subtracted under this step is considered to be the public service cost of operating the Postal Service, and a congressional appropriation equal to such public service cost is authorized by section 2501(b) (1) in order to provide a maximum degree of effective and regular postal service nationwide, both in communities where post offices may not be deemed self-sustaining and elsewhere.)

3. The Board must then estimate the operating income that will accrue to the postal service, and add thereto the amount that Congress is expected to appropriate to the Postal Service in addition to the related appropriations already deducted from the estimated cost. (Normally, the amount added to estimated income under this step would represent the appropriation authorized under section 2501(b)(3), which is designed to reimburse the Postal Service for the carriage of mail for certain mailers free of charge or at reduced rates of postage, pursuant to statutory mandate.)

If the estimated costs, as reduced, are significantly different from the estimated income as supplemented by appropriations under step 3, the Board must notify the Postal Rate Commission of the amount of the difference and request the Commission to recommend a decision on appropriate changes in the rate structure. Such changes must be reviewed at least once every 2 years, unless the Board's estimates of income and costs are approximately in balance, and the Board does not believe that a change would be in the public interest and in accordance with the policy objectives of the statute. It is left to the discretion of the Board whether to submit suggestions as to the specific rate adjustments that the Board may deem suitable.

The Board may also request changes in the mail classification schedule, following establishment of a new classification schedule by the Governors and the Commission within the first 2 years.

It is the responsibility of the Commission, upon receipt of a rate change request from the Board, to recommend a decision on changes in the rate structure which, when implemented, will provide sufficient total revenue to bring the total estimated income and appropriations of the postal service into balance, as nearly as possible, with the total estimated costs. To facilitate achievement of that objective, the bill provides that if Congress should fail to appropriate any part of the funds authorized to be appropriated under section 2501(b), the Board shall request the Commission to recommend a decision on rate changes that will yield sufficient income to close the gap.

When requested by the Board of Governors to recommend changes in rates, fees, or classifications, the Postal Rate Commission is required to consider the request promptly and to afford an opportunity for a hearing, on the record, to the Board, the users of the mails, and an official of the Commission designated to represent the interests of the people. The Commission is authorized to adopt rules which will permit the proceedings to be conducted with the utmost expedition consistent with procedural fairness to the parties.

In recommending rate decisions, the Commission is required to act in accordance with the statutory policy that the costs of all postal operations must be apportioned to all users of the mail on a fair and suitable basis, and in a manner that will not impair the overall value of the service to the people. The rate schedule must be designed, moreover, to make it possible for the postal service to provide prompt, reliable, and efficient service to patrons in all areas.

The Rate Commission must take a number of other factors into account as well, including, first of all, the establishment of a fair and suitable schedule; the value to both the sender and the recipient of the service actually provided each class of mail; operating costs and the amount of institutional costs properly assignable to each class of mail; the effect of rate increases on the general public, on business mail users, and on private entrepreneurs engaged in the delivery of non-letter mail matter; the availability and cost of alternate means of sending and receiving mail matter; cost reductions realized by the postal service as a result of mail preparation performed by the mailer prior to deposit of the mail into the postal system; simplicity of structure of the entire schedule; and such other factors as the Commission may deem appropriate.

In making recommendations concerning the classification of mail, the Commission must act in accordance with the postal policy set forth in section 101(a) and section 102, and must give due recognition to the factors set forth in section 3704(b), including the relative value to the people of the different kinds of mail matter; the desirability of and justification for special mail classifications and services; the importance of providing classifications that recognize different degrees of speed in delivery and in the reliability of such speed; and such other factors as the Commission may deem appropriate.

Any recommended decision by the Postal Rate Commission on rates, fees, or classifications must include a statement in which the Commission specifically addresses itself to the appropriate statutory criteria.

Since the Postal Service is a labor-intensive organization, it is important for the Commission to act promptly on requests by the Board of Governors for recommended decisions on rate or classification and fees. The statute provides that if the Rate Commission should fail to recommend a decision within 90 days of an initial request for action by the Board, the Board may put new rates, fees, or classifications into effect on a temporary basis, upon at least 10 days' notice in the Federal Register. No such temporary change can remain effective for more than 30 days after the Commission has transmitted its recommended decision to the Board.

A decision recommended by the Postal Rate Commission may either be approved or rejected by the Governors. The decision of the Governors must be in writing, must contain a statement of explanation and justification, and must include an estimate of anticipated revenues. If the recommendation of the Rate Commission is approved, the decision of the Governors must specify the date or dates on which the new rates, fees, or classifications will become effective.

If the recommended decision by the Rate Commission is approved, aggrieved parties who appeared in the proceedings before the Commission may, within 15 days of publication of the Governors' decision, appeal the decision to the U.S. Court of Appeals for the District of Columbia Circuit. The court is required to make the case a preference case, and may not suspend the new rates, fees, or classifications during the pendency of the litigation. In deciding the matter, the court of appeals may either affirm the decision of the Governors or order the entire matter returned to the Commission for further consideration. The court may not modify the decision. If the court should return the matter to the Commission for further consideration, the Board, acting with the consent of the Commission, may, at its option, put into effect temporary changes in rates, fees, or classifications.

If they reject a decision recommended by the Postal Rate Commission, the Governors have the option of requesting the Rate Commission to reconsider its recommendation. The Rate Commission must consider any such requests and must make a further recommended decision. Should a further recommended decision not be forthcoming within 90 days, the Board, upon at least 10 days notice in the Federal Register, may make temporary changes that will be effective for not more than 30 days after the Commission has transmitted its recommended decision to the Board.

Upon receipt of a further recommended decision of the Commission in response to a request for reconsideration, the Governors may act upon it in the same manner as if it were an initial recommended decision, and judicial review will be available to the same extent as if the recommendation was being acted upon for the first time. The Governors have an option with respect to such further recommended decision, however, that is not available with respect to initial recommendations. If all of the Board members then holding office concur in writing, they may, by unanimous vote, modify the further recommendation of the Rate Commission. This action may be taken only if all of the Governors expressly find that such modification is in accordance with the record and with the policies set forth in chapter 37 of the bill and the Governors find that the rates recommended by the Commission are not adequate to provide sufficient total revenues. Any such modification would be subject to judicial review in accordance with the provisions of the bill.

The Governors have other possible courses of action open to them on receipt of a recommended decision from the Rate Commission. They may, in the exercise of their discretion, implement a recommended decision of the Rate Commission under protest. In such event, the decision would take effect in the manner proposed by the Commission, and at a time fixed by the Governors, but the Governors could either seek judicial review of the Commission's action or ask the Commission to reconsider and make a further recommended decision. Any such further recommended decision would be acted upon by the Governors subject to the same right of review as exists with respect to action on recommended decisions rendered in response to an original request of the Governors and may be appealed by aggrieved parties to the courts.

Parcel post

Although parcel post as a specific class of mail, and the cost recovery characteristics of parcel post established by Public Law 81–199 and revised in Public Law 89–593, are not included in the bill recommended by the committee, we do nevertheless expect that the historic principle of delivering packages through the postal service will be fulfilled.

Express companies in the private sector of the economy have expressed their very keen desire to include language in the bill which would require the recovery of fully allocated costs for parcel post. The committee rejects the suggestion on the principle that no particular cost accounting system is recommended and no particular classification of mail is required to recover a designated portion of its cost beyond its incremental cost. That decision is for the Postal Rate Commission to determine, in accordance with the general criteria enacted by law. That criteria for ratemaking include seven specific requirements, among them, the effect of rate increases upon "enterprises in the private sector of the economy engaged in the delivery of mail other than letters." To go beyond that point would simply be to recommend provisions of law protecting a particular economic interest or limiting the availability of a Federal parcel delivery service.

The general size and weight limitations of mail matter enacted in the 1966 Parcel Post Act are retained except in the case of letter mail, which shall be established by the Governors upon recommendations of the Commissioners.

Mail Transportation

In fashioning its recommendations on mail transportation, the committee balanced the undoubted need of the postal service for additional flexibility and greater economy against the need for improved postal service for all classes of mail. In doing so the committee could not ignore the present regulatory structure applicable to all modes of transportation.

The committee's recommendations are designed to increase the carriers available to transport the mail, both surface and air, without destroying the carefully regulated economic balance that exists among and within the modes of transportation. The administration proposal is

weighted too heavily in favor of achieving immediate, short term economies for the postal service without sufficient consideration of the long term detrimental effects inherent in the proposal. The administration's proposal, when coupled with recent changes in administration policy on mail transportation, indicates to some students of postal administration that the primary goal of the postal service is to save money without regard to the impact on mail service or the need of the transportation industry for revenues sufficient to maintain adequate, reliable and safe transportation. The committee believes it is necessary at this time to restate its views on the transportation of mail with particular emphasis on the quality of mail service to which the public is entitled.

In 1967, this committee, through its chairman and ranking member, and through the Treasury and Post Office Appropriations Subcommittees of both the House of Representatives and the Senate, prevailed upon the Post Office Department to establish a policy of using the mode of transportation which would afford the most expeditious delivery of mail. One result was the Department's program to provide air transportation on a space available basis for all first-class mail destined for delivery 225 miles beyond the point of origin.

Through the ingenious development of the "air taxi" system and the increased use of scheduled air carriers, the delivery of first-class mail was vastly improved. The informal agreement with the Post Office Department was directly responsible for the speedy enactment of a recent increase in first-class mail that year. Yet, this highly successful program has been unilaterally canceled by the Department without prior notification to the committee. Overnight delivery of first-class mail is now apparently no longer even hoped for.

The committee specifically disapproves this change in policy. It is not in the best interest of the postal service and it should be reversed. All letter mail should be transported by air wherever it will have reasonable assurance of shortening delivery time by one day. Limiting the airlift of letter mail only to destinations 750 miles from the point of origin eliminates 48 of the 50 States from any probability of receiving overnight delivery, and could result in the complete elimination of the air taxi mail program.

No doubt money can be saved, but only with a drastic deterioration of mail service. The Bureau of Transportation for many years established a commendable record of reducing costs and at the same time improving service. The airlift of first-class mail, which the Department now apparently now views as an added cost, was implemented almost entirely with savings achieved by the Bureau from the elimination of inefficient and costly surface transportation programs. Mail service was significantly improved without greatly increased transportation costs. The committee recognizes and appreciates the difficulties the Department has had in persuading the Civil Aeronautics Board to fix rates for the transportation of mail. But the overall impact on the transportation budget on the Post Office Department is minimal while the choice of transportation service has a direct and significant effect upon the mail user. Transportation costs represent about 8 percent of the total cost of handling a letter. But the choice between sending that letter on an airplane or a truck means the difference between

between preferential service and deferred service. The committee believes that letter mail should be afforded preferential service by transporting on the mode of transportation that can assure its earliest delivery.

Surface transportation

The committee generally approves the administration's recommendation on surface transportation. Star route carriers shall be guaranteed an opportunity to negotiate with the Postal Service for mail transportation along with motor common carriers without regard to certification by the Interstate Commerce Commission. The committee believes that this system would be fairer to the star route carriers and would insure against any suspicion of unfairness in negotiating contracts.

The committee has also amended the bill to allow the Postal Service to reimburse railway common carriers for the costs of specific mail delivering equipment purchased by the railroad if the use of such equipment is discontinued; and to permit a motor common carrier to refrain from carrying mail unless it has submitted a general tender of availability to carry mail on all postal routes within the territory it is authorized to serve. Such a motor common carrier shall not be permitted to pick and choose more highly desirable routes at the expense of the railroads or other carriers, but shall make a choice of whether they want to carry the mail or not. The general tender of availability may be withdrawn with the consent of the Board of Governors.

Air transportation

The committee has amended the provisions on air transportation in several important respects. The committee's primary motive is to improve postal service within the present regulatory framework, while at the same time affording the Postal Service more flexibility and economy in the transportation of mail by air.

Under existing law, mail business is divided among scheduled air carriers who are authorized to carry mail generally on a "next-plane-out" basis. A limited amount of mail is carried by air taxis pursuant to exemption authority granted by the Civil Aeronautics Board. All mail rates are fixed and determined by the Civil Aeronautics Board under the Federal Aviation Act of 1958, as amended. In practice, however, the mail rates for air taxi operators are arrived at by competitive bids and subsequent negotiations with the Department under procedures approved by the Civil Aeronautics Board. All air transportation rates, whether for passengers, cargo, or mail, are required by the Federal Aviation Act to be fixed by the Board. In fact, the primary reason for the enactment of the original Civil Aeronautics Act of 1938 was to bring economic stability to the air transportation industry which, at that time, was in a chaotic condition due to destructive competitive bidding for postal mail contracts.

Unfortunately, the procedures developed for the fixing of mail rates are time consuming. The Department's attempts to adjust rates have been subject to long delays. For example, the Congress in 1967 authorized the establishment of air mail service for second-class publications. But the Board has yet to fix a mail rate and this important new service has never taken effect. Such delays are inexcusable and the Board should immediately review its procedures for fixing mail rates. The committee believes that a good faith effort by the Board to establish

new procedures can eliminate these delays. The committee strongly recommends that the Commerce Committees of the Senate and House under whose jurisdiction the Board functions, should also review the Board's procedures for fixing mail rates, so that the Department's requests for mail rate adjustments can be processed in a more expeditious manner. This is a much sounder solution than that advanced by the Department which would, in effect, eliminate the Board entirely from rate making with respect to contracts for the carriage of mail by air. To the committee's knowledge, the Department has never requested through the appropriate legislative committee that changes in the Board's procedures be made. The committee believes the Department should pursue these remedies before resort is had to the drastic alternative of ousting the Board from one of the primary functions vested in it by the Federal Aviation Act.

In order to give the Department greater flexibility and economy in moving mail by air, the committee recommends that contracting authority with air carriers presently authorized by law to carry mail be given to the Board of Governors under the following conditions:

(*a*) The contract be submitted to the Civil Aeronautics Board for a period of 90 days, and if the Board determines that the contract should not take effect, it may disapprove it;

(*b*) If there is no scheduled air service authorized for a certain route and if the Board of Governors determines that it needs air service for such a route not authorized, the Board may temporarily contract with any air carrier until such time as the Civil Aeronautcis Board authorizes scheduled air service between the points involved, and such scheduled service is inaugurated; and

(*c*) If the Board of Governors deems that existing service is not adequate for its needs, it may negotiate contract with air taxi operators.

The committee believes that the latter condition with respect to air taxi operators should be considered carefully by the Department. The air taxi mail program is still in its infancy when compared to the Department's use of scheduled air carriers since the mid-1930's. The Department has yet to develop a sound program for air taxi operators that would provide them a stable basis for the air services they provide the Department. Since the inception of the program, all air taxi contracts have been subject to cancellation by the Department on 30 days' notice. This affords the air taxi operator no predictability or economic security whatsoever. Moreover, the prospects for the Department receiving safe, reliable, and economic transportation service from air taxi operators is lessened. Without the ability to secure financing on reasonable terms and to project revenues beyond 30 days, the air taxi operator is hardly in a position to offer the Department the best safe, reliable service and pass on the economies it could achieve for long term planning.

The Department has developed a sound policy in its relations with surface star route carriers, the counterparts of the air taxi operators. Under the star route carrier program, the Department contracts for the carriage of mail by surface for periods up to 4 years. Such contracts may be renewed for successive contract terms. As a result, the star route carrier program has been highly successful, providing compensating benefits to both the Department and the carriers.

The committee believes the Department should move immediately to implement a similar program for the carriage of mail by air taxi operators. The air transportation provisions recommended by the committee authorize the Department to do so. This is the only method by which long-range stability and economy for the Department and the operators can be achieved. Even with the severe handicaps caused by the present 30-day notice procedure, the committee believes the air taxi mail program has been successful in improving mail service. The committee is convinced the program should be continued and improved in the manner recommended by the committee. The stated goal of overnight transportation of letter mail cannot be achieved without the air taxi mail program.

There was lengthy discussion within the committee on the Department's request for authority to contract with all air carriers for the carriage of mail. Under the Federal Aviation Act, only scheduled certificated air carriers are generally authorized to engage in the transportation of mail. On one hand was the Department's urgent request that it be given the authority in this bill to enter into contracts with air carriers generally in order to reduce its air transportation expenditures and to seek the most expeditious air transportation routes for mail. On the other hand was the impact such authority would have on the present air transportation industry and that this committee would be imposing on the jurisdiction of the Committee on Commerce of the Senate.

The committee decided against allowing the Postmaster General to contract with air carriers not now generally authorized to engage in the transportation of mail. However, the committee does understand the need of the Department to have this authority, and recommends that the Department take this matter up with the Commerce Committees of both the Senate and the House of Representatives. It is hoped that this request would be given every consideration by these two committees having jurisdiction over the Federal Aviation Act.

The Percentage Limitation

The committee recommends that in any contract made with an air carrier under section 5503(a), the mail matter to be transported be limited to not more than 10 percent letter mail, by weight, in domestic contracts, or 5 percent letter mail, by weight, in international contracts. Our reasoning in recommending this limitation on contracting authority is as follows: The Post Office Department has demonstrated a substantial interest in moving mail by air, but has indicated a strong preference for spending less money on mail transportation. The committee is inclined to think that the contracting authority requested would be used primarily to reduce costs, not to move more mail by air. The total weight of all mail now being moved by air constitutes 1 percent of the total weight of all mail. Thus, unless a weight limitation is placed upon contracting authority, all mail now being moved by air could be carried at contract rates and the diversion of letter mail and air parcel post from scheduled rates to contracted rates would be virtually complete. The economic impact upon air carriers would be immediate and substantial with no significant improvement in mail service to the public.

The mail rates established by the Civil Aeronautics Board may very well be too high. The committee is certainly convinced that the present procedures for effecting changes in mail rates are too cumbersome. But

the committe has no reason, upon the evidence available, to believe th the Post Office Department, in wanting complete contracting authority is ready to improve mail service through the increased use of transportation.

The committee believes very strongly that the American people a business are willing to pay more money for better mail service. The only way the committee can insure that the Post Office Department the new postal service will adopt programs for the expeditious deli very of all mail by using air transportation over long distances is by the imposition of the percentage limitations.

On international mail, the weight limit percentage is 5 rather th 10 because the ratio of first-class to total mail in international tra portation is, at 5 percent, almost precisely the ratio of the domestic ratio of first-class to total mail at 10 percent.

After the establishment of the Postal Service, the committee rec mends that the Board of Governors survey the effectiveness of the co tracting authority recommended by the committee and report to th Congress on its implementation. The committee shares the belief of th Postmaster General that the Post Office Department should not be used as a crutch for the economic well-being of the air transportation industry. But it cannot recommend such a fundamental change requested by the Department, particularly since the jurisdiction to consider such changes rests in other legislative committees.

Other Provisions of the Bill

The committee recommends that the postal service study and subm to Congress within 2 years its veiws on the necessity for a revision of the private express statutes.

The committee recommends that the prevailing rates provisions of the Davis-Bacon Act be made applicable to postal facilities constructed under a lease operating if the total interior floor space is 6,500 square feet.

The committee approves the recommendation of the administration for an 8-percent pay increase, effective on the date of enactment, for employees in the postal field service. The committee does not approve such an increase for employees in the headquarters of the Post Office Department who are subject to the general schedule of the Classification Act. Such an increase would put those employees much higher than their counterparts in other agencies in similar jobs who do not receive the 8-percent increase.

The additional cost of the pay increase for employees in the postal field service will be approximately $500 million on a full fiscal year basis.

INDIVIDUAL VIEWS OF MR. YARBOROUGH

This bill, in its present form, more than 150 pages long, was introduced so late in the course of the hearings and negotiations on the postal bill, and came to us so late, that there was no opportunity to amend it before it was passed on in committee.

I think that we should raise the pay of the postal employees to a comparable status with other Government employees and consider that changes, reforms, or improvements are needed in the Post Office Department in a separate bill. I propose that we raise the postal pay immediately by 8 percent, which when added to the previous raise, would be a total increase of 14 percent, and would bring the postal employees to parity in the Government wage scale. I would accompany this with a raise in the first-class postal rate from 6 cents to 7 cents for 1-ounce letter, with a comparable 16½-percent increase on all other postal rates across-the-board. This would raise more revenue than the amount of the increase in the salaries of the postal employees.

In my opinion, we should not use exorbitant postal rate increases as a means of ending the deficit in the Federal budget. The budget deficit is an overall, all-Government expense, and we should not make the postal employees and the postal patrons the goats of this deficit. Recent proposals from the administration of an 8-cent first-class letter rate, or a 10-cent first-class letter rate, are designed to help wipe out the deficit in the Federal budget. The postal service deserves better of the Congress and the administration than to be the whipping boy for big deficits in big government. It is and should remain a service organization in the charge of the Government, and I shall support it in that form.

Groups of postal employees, as well as groups of mail users, have complained to me of inequities in the present bill if the moneymaking, budget-balancing, anti-public-service, corporate method is saddled on the Post Office Department. I favor continuing the Post Office Department as a service organization for all the people of our Nation, a branch of the Government of the United States.

SUPPLEMENTAL VIEWS OF MR. HARTKE

I am in accord with the principles of postal reform proposed
. 3842 and subscribe to the views of the other members of the c
mittee expressed in the report. Postal reform is long overdue and t
rovisions of the bill will go far to correct the glaring deficiencies
the present system as well as provide an effective framework for m
dized general improvement of the postal system in the United Sta

Unfortunately, certain provisions of the bill which I consider m
mportant are either vague or intentionally unrepresentative of
oints of view and principles of law they are designed to express.
ll cases, the language of the bill is identical to the language submitt
y the Post Office Department and I therefore assume that the auth
re the Postmaster General and his advisers. The language to which
fer provides for the conversion of postal employees to a new P
ostal Service agency and establishes the framework for their tr
ces as employees in the Government of the United States. I think t
anguage is deficient, defective, subject to misrepresentation, m
nderstanding, and should be completely revised in order to say exac
hat it means. It does not do so in its present form.

For instance, section 1104 of the bill says that "officers and employ
f the Post Office Department on the effective date of this section sh
emain officers and employees of the postal service under the terms
his title." Unfortunately, it does not say what those terms are. It m
overs some 750,000 American citizens who are employees of the P
ffice from the competitive civil service system established by the C
ervice Act of 1883 applicable to almost all appointive positions in t
xecutive branch of the Government. They are in my judgment h
limbo, subject only to what can be bargained for by postal mana
ith postal management after the enactment of this act. Career st
the most important and enduring part of Federal employment a
eans of insuring against the spoils system or the arbitrary and c
icious actions of an employer, and yet it is literally taken out of the
ords and in its place they are given some vague assurance of a "c
ervice" system that is undefined and thus far undeveloped.

Since I have been a member of the Senate, postal employees ha
eceived many benefits. Just a few include the Federal Employe
Health Benefits Act; the postal employees overtime pay provisions
Public Law 89-301; the Severance Pay Act of 1965; the Governm
Employees Salary Comparability Acts of 1962 and 1967; and a nu
of other provisions of law which have been enacted or modernize
create very specific and very cherished rights and benefits for po
as well as other Federal employees.

. 3842 wipes out all of those benefits, of any kind, regardless
importance, but says that fringe benefits shall continue to apply
changed by the Postal Service in accordance with collective bar
ing, and that no changes shall result in a program which "on the
is less favorable to the officers and employees" than those e

ed before the enactment of this act. I much prefer a very positive
a very specific prohibition against any reduction of any benefits
ny kind either direct or indirect until new programs have been
blished and put into effect with the approval of the employees or
ir bargaining representatives. I do not believe that my very good
ends in the postal service will think it unkind of me to say that their
dom and experience in collective bargaining, as demonstrated in
ir collective bargaining sessions with the Postmaster General, dem-
trated that they need to be very careful of signing pieces of paper
il they are exactly sure of the content and meaning of the language
the paper.

One of the more intriguing sections of the bill is that related to the
ployment rights of men and women who have served in the Armed
rces of our country. Under existing law, a veteran of the military
vice entitled to preference has a right to be selected over a person
t entitled to veteran's preference, both when he is appointed or when
duction in force necessitates selection out. The Veterans' Prefer-
ce Act of 1944 is one of the most important provisions of law re-
ing to our military servicemen in the Federal Government and yet
Post Office Department recommends modification of veterans pref-
nce by saying, in the first instance, that retention preference will
subject to collective bargaining (or to modification by the Postal
rvice with the approval of the Civil Service Commission) and then,
r on, in section 1101(d), stating "those provisions of title 5 which
re formerly known as the Veterans Preference Act shall apply to the
tal Service." If the Postmaster General and his staff are referring
chapter 35 of title 5 (relating to preference eligible) they should
so rather than using a vague wave of the hand toward the statute
ks. If veterans preference is going to be subject to bargaining, the
should state very specifically what aspects may be bargained away
d what guidelines should be established by law to insure safeguards.

Changes in Existing Law

The committee believes that the inclusion of language showing
nges in existing law made by the bill as reported would delay the
editious consideration of this legislation and the business of the
nate. Section 2 of S. 3842, as reported, is a complete substitute for
39, United States Code. All of title 39 as it presently exists in law
epealed.

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March 31, 2003

VIA EMAIL (jana.white@do.treas.gov)

Mr. Dennis Shea
Executive Director
President's Commission on the U.S. Postal Service
1120 Vermont Avenue, Suite 971
Washington, D.C. 20005

Re: Written Submission of the National Star Route Mail Contractors' Association Testimony to the President's Commission on the U.S. Postal Service

Dear Mr. Shea:

I write to you today as the President of the National Star Route Mail Contractor's Association (the "Association"). The Association is a not-for-profit association that ultimately represents more than 17,000 small businessmen and women who provide surface transportation for the U.S. Mail and the United States Postal Service (the "USPS"). The Association's constituency is comprised of a variety of members who perform various tasks for the USPS, some of which are outside the scope of the USPS's normal functions, and some of which are performed by USPS employees. As an example, approximately 7,000 of our members are box delivery contractors who perform the same task of actually delivering mail to rural America, as do the USPS rural carrier employees.

The Association was organized to advocate the legislative and regulatory needs of its member contractors at both the state and federal government levels. The Association and the USPS have enjoyed a long and storied past of cooperation. In many respects, the USPS and the Association can be characterized as having worked hand-in-hand, as partners, to better the USPS and ourselves, while always having been cognizant of the goals and purpose of the USPS and its product – delivering the U.S. Mail. In fact, we have a joint policy committee which meets two or three times a year to discuss policies having a mutual impact, a good example of private – government interaction. Of course, the Association and its members are intent on maintaining this partnership relationship with the USPS for many years to come.

In the spirit of partnership and progress, we offer this written testimony for the President's Commission to consider when performing its daunting task of identifying the operational, structural, and financial challenges that face the USPS, examining potential solutions, and ultimately recommending to the President of the United States legislative and

administrative means to ensure the viability of the USPS long into the future. The USPS highway contracting industry (the "industry") is well aware of the importance of maintaining the viability of the USPS, not only for the benefit of the industry, but also for the benefit of the USPS and the hundreds of millions of Americans who rely on the USPS's services. The industry and the Association applauds the initiative taken by the President and the Commission to investigate the status quo of the USPS, and to recommend steps to be taken to streamline it, as well as improve its operation. It is on this premise that the Association bases its recommendations as is set forth more fully below. The industry, as it has historically done, desires only to further improve upon its partnership with the USPS, and to assist the USPS in any way it possibly can.

It is in this context – looking over our 200-year-plus history and mindful of today's practices and problems – that we offer our example as a model for this Commission to harness the competitive power of the market place with the certainty, celerity and security of a public sector model.

This Commission is well aware of the issues, or potential issues which the USPS faces now and in the future. Thus, forsaking redundancy, I will not rehash them. The industry is also aware of these issues. However, the catalysts for our work together are private industry opportunities and the advancement of communication technology. The Association views the appointment of this Commission as a rare opportunity for the USPS to re-invent itself in order to bring it into the 21st Century. Although the Association believes that in the abstract the status quo has many compelling features, it also believes that some changes allow the USPS to better serve America, and, in the end, continue to be self-sufficient as an independent, federal government activity.

Ultimately, the Association embraces and champions the views of the overwhelming majority of those persons or entities who have previously testified before this commission — that the USPS must remain in the hands of government to provide universal service to the millions of Americans who have relied on the USPS for hundreds of years. The Association defines "universal service" as the USPS maintaining its current monopolies, and continuing its six-day mail service. The Association does not believe that complete privatization of the postal system in the United States is the best solution. Rather, the Association, along with the consensus of Americans, believes that the hybrid system of service that is currently employed by the USPS is still the premiere solution — i.e., the USPS is ultimately responsible for "putting the mail in the box," but it contracts with private industry to harness the benefits of competition to perform various tasks to allow the USPS to most efficiently perform its function and responsibility.

In the Association's view, the solution to the issues and difficulties currently facing the USPS, and those it will encounter, is simple. The USPS must restructure and streamline its business and administration models to (1) permit the USPS to more efficiently and effectively perform its function, and (2) ultimately allow the USPS to venture outside of its perceived

"monopoly-only" purposes and compete with private industry in non-monopoly markets and services to allow the USPS to reclaim some of the services that it has effectively given away to its private industry competitors in the past. To accomplish this goal, first, Congress must cooperate and enact legislation giving the USPS the flexibility to act more independently, but with accountability. In turn, the USPS must look internally at its resources to responsibly carry out its burden of accountability.

One of the USPS's best and most loyal resources is members of the industry. Even before the United States established the USPS, history documents people — everyday, private citizens — like the current contractors, who would carry the mail from post to post. Since the 1800s, the highway contractors and the USPS have maintained a constant and a genuine symbiotic relationship — one cannot survive without the other. At the heart of the industry's contributions to the success of the USPS is service with certainty, celerity and security. It is therefore necessary that the USPS and the highway contracting industry, through the Association, continue to work in conjunction to better the USPS.

The industry believes that the USPS has chosen a course recently which could damage the relationship between the USPS and the industry. In the Association's view, the derogation of the relationship is in large part due to the USPS's focus on bottom-line economics — in other words, the greater the cost savings, the better for the USPS and those that rely on its services. As is more fully set forth below, the Association believes that the USPS has focused entirely on the immediate, panacea-like policies to save costs today, but those policies will eventually erode the underlying tenets that have historically ensured that the USPS can perform its function, and will ultimately culminate in the USPS's decline if they are not re-focused.

We believe that the following issues should be investigated and ultimately altered:

- **The USPS should not use "reverse auctions" to solicit bids for transportation services**

The USPS should do away with the current practice of conducting "reverse auctions" for contracts, where the maximum amount is posted and the lowest bid is disclosed. This practice encourages cut-throat bidding and, for the reasons stated above, will ultimately kill our industry and the USPS's suppliers. Sealed bidding and offers have been the hallmark of government contracting for years. Sealed bidding is a convenient method to allow each contractor to analyze its own ability to provide the service, while not losing money. The USPS's current practice of conducting reverse auctions is nothing more than a scheme to get people to make mistakes and find themselves in financial trouble with the resulting inability to perform. Reverse auctions, in theory, can work when dealing with a commodity, a constant. However, it is undisputed that the transportation business is unpredictable and unstable. Therefore, the USPS must ensure that it has a reliable and solid work force of contractors at its disposal at all times. The USPS should maintain the integrity of its contractors' financial and performance abilities, and immediately do

away with reverse auctions for contracts and other matters. Reverse auctions will lead to the elimination of small, independent, and women and minority owned businesses who must bid contracts to stand on their own versus a corporation that could buy the service and support it with other corporate assets. Many small businesses and minorities do not have the administrative staff or resources to sit at a computer terminal looking for opportunities.

- **USPS should avoid intruding into its contractors' businesses**

A contractor who bids to run a certain route for the USPS must be able to control his or her ability to negotiate with his or her suppliers. The USPS has embarked on a program to require all contractors to obtain fuel from a single supplier chosen by the USPS. The stated purpose of this initiative is to reduce the highway contracting industry's collective fuel costs. They have intimated that they may well extend this to other items purchased by the contractor.

In fact, a voluntary program already exists in this regard. Contractors may purchase tires at the same price as those bought by the USPS for its internal fleet. The tire supplier requires a contractor to complete a certification of eligibility, and a USPS contract number, in order to purchase tires at the reduced cost. This lowers the contractors' expense and costs the USPS nothing for administration.

The industry agreed to a similar voluntary program for fuel purchases. The USPS should negotiate the best price per gallon for its fleet, and make the fuel available to the industry. They contend that they cannot achieve the desired price without controlling all purchases, both internal and external. We hired a respected fuel consultant who disagreed. He contended that it was not necessary to bundle all gallons purchased to achieve the lowest cost.

We are independent business men and women. We believe in the "invisible hand" of Adam Smith that controls the marketplace. Economic freedom is inseparable from the other freedoms we enjoy in the United States. We trust that contractors who can benefit from voluntary purchasing under a USPS program will do so. We do not believe in a centrally run economy. It is both unnecessary and undesirable. The free exchange of goods and services between individuals has formed the basis for American economic life for over 200 years.

The USPS seeks to avoid being micromanaged by the U.S. Congress, while it is concurrently engaged in this attempt to micromanage our industry. If it could move the mail at lower overall cost than the contracting industry, it would. The USPS fuel program will build an internal bureaucracy and create an unnecessary distraction for postal management. It limits competition between contractors, and runs entirely counter to a free market economy. The USPS should refrain from instituting policies that limit or restrain a contractor's ability to be competitive. This system is forcing out small and minority owned businesses. Some local fuel vendors have already been forced out by this fuel initiative. Could local truck dealers be next? Individual USPS contractors are economically stressed. Breakdown of the network will not

serve USPS well in the long term. No one will, or can, sell below the cost of production in the long run. This could be a short term benefit, but a long term disaster.

- **USPS should lighten up in its exuberance to weaken indemnity provisions in contractors' agreements**

In most four-year service contracts, the USPS has insisted that clauses be inserted which weaken indemnity provisions due to the contractor for a contract cancellation for convenience of the USPS. However, and conversely, contractors still bear all risks of the USPS liability for termination and or breaching a contract with the USPS. Unless the parties have mutuality of obligation and consequence, the strong, competitive base of mail haulers will quickly be diluted, and the USPS will eventually lose all bargaining power and security it has now with the industry. Indemnity often provides the security to financial institutions for small businesses and minority contractors to receive loans to purchase equipment.

- USPS must continue to bargain in good faith

In an apparent effort to cut its costs, the USPS has endeavored, in some cases, especially in the 1990s, to throw out good faith and fair dealing in contracting with the industry. More specifically, the USPS has attempted to compel contractors desiring to renew contracts to renew at lower rates, for the same rate but increased service, by using questionable comparable routes and contract amounts, and by changing contract terms during the term of the contract without the contractors' consent to terms more favorable to the USPS. The Association believes that the USPS's desired effect in using such tactics is to obtain the lowest bids possible. However, cut-throat bidding does not ensure reliability, and in fact, tends to increase risks of unreliability of those who simply bid the lowest amount. If the USPS continues on this course, the USPS cannot, in the future, ensure that the same, dedicated mail haulers who service the USPS today will be around in the future. In addition, the Association is confident that the USPS will encounter more situations where a contractor cannot perform. The USPS must refocus its efforts to its primary, and greatest resource - its infrastructure and support (i.e., its employees and its suppliers and contractors). In its transformation plan and DN proposed business plan, the USPS expresses a desire to reduce its contractor base via consolidation of small routes into one larger route. President Bush, while Governor of Texas, did the reverse and broke apart large businesses into smaller companies to share in the business. If the USPS consolidates routes, it could lead to the elimination of many small, family-owned, women, and minority-owned businesses which now provide excellent service to the USPS.

** TOTAL PAGE.07 **

- **The USPS must be required to follow federal law and, where it is supposed to, take appropriate action to ensure it is getting quality service**

The federal Prompt Payment Act requires the USPS to pay interest on overdue obligations due, among others, contractors. However, in most instances, the USPS ignores this liability. Again, what are contractor's to do? All bargaining power has been stripped from the contractors, and they simultaneously bear all of the risk.

In addition, although in many cases (depending on the issue), the USPS preaches as justification for actions that it is attempting to ensure the safety and/or security of its services, in many other instances, wherein the benefit clearly is not as great, the USPS fails to follow its own responsibility to ensure that a successful bidder of a contract is complying with the requirements of the Service Contract Act. In effect, the USPS benefits by the violations or failures to correct a violation by an unqualified contractor because presumably if the successfully bidding contractor is not complying with the standards of the Service Contract Act, the USPS is receiving the service at a reduced cost. In today's day and age, and given the September 2001 security issues that arose, the last thing the USPS needs or wants are rogue mail haulers whose only qualification for winning the bid is that he or she bid the lowest. Rather, the Association believes that the USPS believes that the mail must be delivered safely. The fastest way to erode the USPS's confidence that its mail is being transported safely is to drive those that the USPS trusts most out of business. The Association, therefore, would hope that the USPS holds itself to a greater responsibility to examine to whom or to which it awards its bids and be flexible enough to consider other important matters other than cost. Homeland security could become a serious issue if the USPS awards transportation contracts to people or firms whose reputation and integrity is little known, or not known at all.

The Association, on behalf of the highway contracting industry, thanks you and the commission for the opportunity to provide you with this information. We certainly applaud your efforts and hope that you will call on us if we can provide to you further assistance.

Very truly yours,

Robert B. "Brownie" Matheson
President
National Star Route Mail Contractors' Association

Written Testimony

Submitted by

John F. Sturm

President and CEO

Newspaper Association of America

Before the

Government Reform Committee

Special Panel on Postal Reform and Oversight

February 11, 2004

On behalf of the Newspaper Association of America (NAA), I am pleased to submit testimony today before the Government Reform Committee Special Panel on Postal Reform and Oversight at its hearing on "Answering the Administration's Call for Postal Reform." NAA is a national trade association representing nearly 2,000 newspapers in the United States and Canada, accounting for nearly 90 percent of the U.S. daily circulation. While most NAA newspapers are dailies, many weekly newspapers are also members.

Congress has an historic opportunity to fix the problems that face our nation's postal system and to set the Postal Service on a path of better service, greater operating efficiency and stronger finances. As customers with a long history with the Postal Service, newspapers want a healthy and vibrant postal system to serve our needs—and the needs of the nation—for generations to come. NAA looks forward to working with the special panel, the full committee, the Postal Service and other mailers toward sound postal reform.

EXECUTIVE SUMMARY

The nation's postal system was largely created to deliver newspapers so citizens settling the American frontier could stay connected and informed. Throughout our history, newspapers have served as partners with the Postal Service in its mission to "bind the nation together." Congress has consistently affirmed the importance of newspapers and other periodicals by adopting policies supporting their educational, scientific and cultural information values.

Newspapers today are among the leading local users of postal services and, collectively, the industry spends well over $700 million on all classes of mail. Newspapers depend upon the Postal Service each day for the delivery of newspapers and our total market coverage products that are sent to the homes of non-subscribers. Newspapers also have a strong interest in First Class Mail as, unlike most businesses, we collect the majority of our revenues through the mail.

Newspapers, whether large or small, daily or weekly, serve as vehicles for news and advertising. Generally, there are two kinds of newspaper advertising. One commonly called "ROP" ("Run of Press") is printed on the pages of the newspaper. The other, called "pre-prints" consists of free-standing inserts, which are either placed inside the folded newspaper or mailed to non-subscribers.

It is important to note that newspapers compete with direct mailers (principally "saturation" mailers) for both types of advertising, particularly for pre-prints. Newspapers have been very concerned, over the years, that the Postal Service has inappropriately chosen to favor our advertising competitors by engaging in pricing strategies and new initiatives targeting the advertising revenues upon which we depend to support the news and editorial content of our newspapers. NAA does not believe the Postal Service —an agency of the federal government—should take sides in the marketplace competition between newspapers and other advertising media.

Newspapers believe many of USPS' financial problems are due to a lack of authority and regulatory tools at the Postal Rate Commission to ensure the Postal Service is accountable to the American people, is financially self-sufficient and stays on course to fulfill its public service mission. As described in greater detail below, NAA supports many of the recommendations outlined by the President's Commission on the U.S. Postal Service. Here is a summary of the newspaper industry's views on specific postal reforms:

- NAA supports re-affirming the U.S. Postal Service as a public service with a mission of providing universal mail delivery at affordable and non-discriminatory rates.
- NAA supports the creation of a Postal Regulatory Board—with new regulatory tools—that will protect the public interest and ensure the Postal Service is completely accountable and transparent in its finances and operations.
- NAA supports providing USPS with the operational flexibility to close, consolidate or relocate postal distribution and processing facilities.
- NAA supports giving the new Postal Regulatory Board the authority to "ensure that the Postal Service is appropriately allocating its costs across its competitive and non-competitive products and services."
- NAA supports an expedited rate-setting process that would also protect mailers from unjustified or flawed rate proposals before they are implemented.
- NAA supports an appropriate amount of rate flexibility within an index, as long as costs are appropriately measured and allocated, and safeguards are constructed to prevent rate discrimination among mailers.

- NAA is opposed to a government service offering special rates for individual mailers in the form of "negotiated service agreements," special rate arrangements that are not made available to all mailers. Newspapers support discounts for properly identified and measured work-sharing activities, which may include niche classifications.

THE POSTAL SERVICE IS A PUBLIC SERVICE

Congress established the U.S. Postal Service as a fundamental public service with a mission of providing universal mail service at affordable and non-discriminatory rates. We believe this approach, which is as old as the republic, is the right one. NAA applauds the Presidential Commission for rejecting suggestions by some to re-create the Postal Service as a "commercial enterprise" that has a particular interest and stake in private markets.

As Congress examines proposals for modernizing the Postal Service, it is important to note that the Postal Service is far from an ordinary business. The Postal Service is an enormous quasi-governmental enterprise with nearly $70 billion in annual revenues. To accomplish its public service mission, Congress bestowed the Postal Service with a wide range of important and powerful privileges, including a legal monopoly over the delivery of letter mail, and exemptions from taxes and most federal, state and local regulations.

Unfortunately, for many years the Postal Service has often operated with very little accountability. Without effective oversight, the Postal Service has not only failed to have

financial transparency (as has been well noted by many), but it has felt free to undertake ill-considered initiatives for the benefit of its own interests or that of the direct mailers who compete with newspapers.

For example, several years ago, the Postal Service launched an experimental program called Auto Day that would have spent $10 million on advertising and sales to divert automobile advertisements from the Milwaukee Journal into the mail. Last year, a "sales force" of Postal Service employees were making sales presentations to newspaper advertisers across the country encouraging them to use direct mail advertising over other media through the NetPost Mailing Online service that the Postal Service then offered. Over the years, the Postal Service continued to advance the misperception that it is in the direct mail and advertising business. A recent example was its description, in its Transformation Plan, of saturation advertising mail as "low hanging fruit." The Postal Service should deliver the mail for the benefit of all its customers and not pick sides in the competition over advertising between two of its mail customers.

While historically newspapers have been concerned about the Postal Service's forays into the advertising markets, we are encouraged by the actions of Postmaster General Jack Potter who has taken steps to refocus the U.S. Postal Service on its core service of mail delivery. NAA specifically commends PMG Potter for halting many e-commerce activities that not only created unnecessary costs, but diverted the attention of postal management from its public service mission.

NAA VIEWS ON THE PRESIDENTIAL COMMISSION'S RECOMMENDATIONS

NAA is pleased to provide specific comments on the recommendations of the President's Commission. We have read the thoughtful statements of the Postmaster General, Chairman George Omas of the Postal Rate Commission, and David Walker of the General Accounting Office, and concur with many of their observations.

EFFECTIVE REGULATION OF THE POSTAL SERVICE IS ESSENTIAL

Newspapers continue to support the existence of the Postal Service's monopoly as the most effective way to achieve the Postal Service's core public service mission. We remain concerned, however, that the Postal Service may continue to use its monopoly privileges to the detriment of private markets and the individual mailer, both in so-called non-competitive markets, but also, through flawed costing and pricing, in competitive markets as well.

If Congress is to continue the Postal Service's monopoly status, which the Presidential Commission recommended, a rigorous regulatory framework is absolutely essential to protect mailers from excessive rates, cross subsidization and unreasonable rate discrimination. While we appreciate the hard work of the Postal Rate Commission, the current statute does not confer it with appropriate tools to regulate the Postal Service. The Presidential Commission recognized the need for a strong and effective "Postal Regulatory Board" that would be given new tools—nonexistent today—to protect the public interest

and ensure that the Postal Service is accountable and completely transparent in the way it handles its finances and its operations. NAA supports this recommendation.

USPS OPERATIONAL FLEXIBILITY TO CONTROL COSTS

While costs for the U.S. Postal Service have continued to outstrip revenues, postal reform proposals in the past have primarily focused on "pricing" as a way of solving the Postal Service's problems rather than setting sights on cost controls. We believe that improving the Postal Service's cost-effectiveness would benefit all mailers, and offers more long-term promise than pricing changes that in practice would likely benefit only some mailers.

NAA supports the Presidential Commission's recommendations regarding the consolidation and rationalization of the mail processing and distribution network. NAA also believes that, without congressional intervention, the Postal Service should be given the operational flexibility to close, consolidate or relocate processing facilities that do not meet reasonable public service and productivity standards. However, we also stress that small, seemingly "unprofitable" post offices can often be indispensable for small communities, and that the role of the local post office in binding the community and the nation must not be discounted completely.

As mailers, we sympathize with the desire to give the Postal Service incentives to reduce costs and operate efficiently. I must point out, however, that apart from issues as to

what is an appropriate level of pricing flexibility in the presence of a monopoly, such proposals at least implicitly suggest that postal costs increase fairly evenly across classes of mail. Unfortunately, experience teaches that this is seldom the case.

IMPROVEMENTS IN MEASURING AND ALLOCATING COSTS

The Postal Service claims that the rate for a single-piece basic First-Class stamp (now 37 cents) has kept pace with inflation since the Postal Reorganization Act. Interestingly, however, during an era in which the price of a telephone call has fallen dramatically and high-speed Internet access has become widely available at declining prices, the price of the First-Class stamp continues to rise. This has happened despite huge investments in highly sophisticated sortation equipment over the past decade and the widespread use of barcoding. All of this suggests that the First-Class stamp rate is higher than it should be.

As active participants in postal ratemaking under the current law, we believe that there are two reasons for this excessive First Class rate. One is a failure to attribute costs properly among First Class and Standard Mail. The other is a long history of placing an excessive burden of the "institutional" costs of the system on First Class mailers. Together, these factors have kept First Class Mail rates too high and have resulted in preferential rates for saturation mailers. Ironically, the problem the Postal Service now faces is that decades of exploiting its monopoly may finally have killed the golden goose,

as citizens and small business mailers increasingly are exploring alternatives to First Class Mail delivery.

To address this enormous problem, NAA supports the Presidential Commission's recommendation to give a new Postal Regulatory Board the authority to "ensure that the Postal Service is appropriately allocating its costs across its competitive and non-competitive products and services." The Postal Regulatory Board should, in a separate proceeding, establish the methodology used for calculating and allocating costs because, as the GAO stated recently, the responsibility for assigning costs should belong to an independent regulator "in which the outcome cannot be unduly influenced through the selective provision of information to the regulator." NAA believes this recommendation alone would contribute significantly to a more accountable and financially transparent U.S. Postal Service.

AN EXPEDITED RATE SETTING PROCESS

The Postal Service and others have complained that the current ten-month process to review rate proposals is too long for the Postal Service to respond to changes in the competitive marketplace. Frankly, given the enormous size and scope of the Postal Service, its huge base of monopoly revenues, and its control over all of the costing data, NAA believes that the current ten-month prior review process compares quite well to other ratemaking systems. Nonetheless, NAA is certainly willing to work on ways to improve and streamline the rate-setting process.

Today, the length of rate cases often has no relation to specific rate changes but is the result of disputes over the formula and methodologies used for measuring and allocating costs. Empowering the regulator to decide costing issues in separate proceedings could greatly accelerate ratemaking while preserving the safeguard of prior review. For this to be effective, the Postal Regulatory Board must have increased powers, such as the powers to issue subpoenas and to compel the Postal Service to prepare and make available cost information and other data.

RATE PREDICTABILITY AND FLEXIBILITY WITHIN AN INDEX

The Presidential Commission has recommended that the Postal Service should be allowed to set rates on its own within certain limits established by the Postal Regulatory Board. Under the proposed approach, rate ceilings would rise by no more than inflation. Within a rate index, the Postal Service would have the flexibility to make annual rate adjustments for non-competitive services without prior review by a regulatory body. At the same time, mailers would be protected from large and frequent rate increases. The idea is that the Postal Service and mailers would benefit from more predictable, and presumably smaller, rate increases. NAA generally supports this approach.

It is important to note, however, that proposals for rate indexing, coupled with after-the-fact review, implicitly assume that costs increase relatively uniformly across postal classes. This is not so. Indeed, the wide range of differences between the classes

and subclasses in collection, mail processing, and transportation practices and technologies, and the relative use of each function by the various subclasses guarantee that cost changes differ among classes of mail. Therefore, any system of rate indexing must consider how to address the consequences of above-inflation cost changes for some, but not all, subclasses.

While NAA supports rate predictability and rate discipline as desirable outcomes, those are not the only important outcomes of a revised ratemaking regimen. Other vital criteria are: (1) that all mailers pay rates that cover their costs, thereby preventing cross-subsidies; (2) that costs upon which rates are based must be correctly measured; and (3) that discounts reflect cost differences. The challenge is to develop a system that accomplishes all of these goals. NAA believes that an experienced Postal Regulatory Board would be fully capable of devising such a system.

PRIOR REVIEW TO PROTECT MAILERS FROM FLAWED RATE CHANGES

NAA respectfully submits that, whether or not a rate indexing system replaces the current cost-of-service system, mailers would face considerable risk if a prior review of rates—before implementation—were eliminated.

History teaches that prior review protects mailers from not only unreasonable rate changes, but rate proposals that may be based on flawed or unreliable data. For example, only a few years ago, the Postal Service submitted rate proposals to the Postal Rate

Commission that would have raised rates for out-of-county weekly newspapers by 35 percent. Newspapers, particularly weeklies, were shocked by the proposed rate increase. Prior review of that proposal before the Postal Rate Commission gave rise to the discovery by the Postal Service that the formula it used for determining the out-of-county rate proposal was seriously flawed. In fact, after using more reliable data, the Postal Service proposed a 1.5 percent rate decrease for out-of-county weekly newspapers rather than the earlier proposal of a 35 percent increase.

Only prior review was able to avert serious economic harm. If a 35 percent increase in postage had been implemented without a review by a neutral and independent body, it could have caused irreversible harm to weekly newspapers. Since postage is a large percentage of a weekly newspaper's operational costs, an unjustified postage increase, based on a flawed analysis, could have put some newspapers out of business. No after-the-fact remedy could have rectified the damage done.

NAA believes mailers should be given the opportunity to challenge postage rate proposals before they are implemented. Indeed, as a practical matter, this is implicit under H.R. 4970, Burton-McHugh-Waxman compromise bill drafted in May, 2002, so long as the regulator has the power to enjoin a proposed rate change from taking effect. This is because, in practice, the Postal Service must give advance notice of any rate changes in order to forewarn mailers and give time to update mail preparation software, etc. If the regulator has the power to intervene before the rates take effect, mailers may have protection from flawed or unjustified rate changes.

Indeed, that approach resembles a model often used by federal and state regulators in which the regulated service provider publishes advance notice of an impending rate change, and that rate change takes effect absent intervention by the regulator. The Federal Communications Commission, for example, applied that procedure for many years before the industry became largely deregulated. A regime in which the Postal Service could propose rate changes, subject to cost attribution methodologies set by a regulator and an expedited process before the rate change took effect, could significantly enhance the Postal Service's pricing flexibility while preserving the safeguards of prior review.

NEGOTIATED SERVICE AGREEMENTS ARE DISCRIMINATORY

While some pricing flexibility within a rate index and an improved system for measuring and allocating costs could be beneficial to all mailers, as well as the Postal Service, NAA believes strongly that the Congress should prohibit the Postal Service from offering special rates for individual mailers in the form of "negotiated service agreements." Although newspapers are often the largest mailer in their markets, we believe market economies have no room for contract rates by governmental service providers that have no shareholders, pay no taxes, enjoy government privileges and exist on a history and infrastructure paid, to a substantial degree, by taxpayers. Government services—here, postal services—should not be for sale on the basis of negotiating or lobbying skills.

Newspapers believe there is a big difference between (1) negotiated service agreements that selectively confer unique benefits on favored mailers, and (2) encouraging and rewarding all mailers for work-sharing activities. Newspapers have long held the view that postal discounts and work-sharing arrangements should be available to all mailers who meet predetermined criteria for those rates, and such discounts should be based on demonstrated cost differences. In fact, postal rates today include numerous generally-available discounts for so-called "worksharing' activities such as barcoding, dropshipping, and presorting.

Mailers large and small can perform these activities, which benefit both the mailers and the Postal Service. For our part, newspapers have invested huge amounts of money in work-sharing efforts that reduce the Postal Service's costs while improving the service that our products receive. By working with all mailers, the Postal Service will be far better off than if it devotes its time and resources to cut special deals with individual mailers.

The Presidential Commission recommended allowing the Postal Service to negotiate special deals with favored mailers, subject only to after-the-fact review. NAA respectfully opposes this recommendation. We believe prior review of arrangements that could confer significant competitive advantages of selected mailers is essential. As the Postal Rate Commission has observed, such arrangements can easily have undesirable "external" effects on other mailers (especially those that compete with the NSA mailer), which the Postal Service might well not consider during the negotiations. In fact, the Postal Rate Commission and the GAO have been critical of the Postal Service for failing to

possess costing information that is critical in determining whether the USPS is truly better off as a consequence of a proposed deal.

The Presidential Commission also recommended that negotiated service agreements should be made available to similarly-situated mailers. Congress should recognize that such is not the case with the Capital One NSA. Over a year has passed since that deal was announced, and nearly a year since it was approved, without a second mailer, including competitors to Capital One, having access to the same deal. This is because in the Capital One NSA, the Postal Service reserves the right to negotiate with whomever it pleases and is under no enforceable obligation to allow any other mailer to obtain a similar arrangement. That experience confirms to us that negotiated arrangements for individual mailers are inherently discriminatory and should be abandoned in favor of arrangements that take the form of what the postal community calls "niche" classifications, available to all mailers that meet reasonable published criteria.

CONCLUSION

NAA appreciates the opportunity to present our views on some of the recommendations and issues raised in the President's Commission on the U.S. Postal Service. Newspapers look forward to working with the Special Panel on Postal Reform and Oversight on reform measures that strive to improve the Postal Service as a public service that will serve the interests of all mailers.

TESTIMONY OF TIMOTHY J. MAY,
GENERAL COUNSEL OF THE PARCEL SHIPPERS ASSOCIATION
BEFORE THE
SPECIAL PANEL ON POSTAL REFORM
AND OVERSIGHT, COMMITTEE
ON GOVERNMENT REFORM,
HOUSE OF PREPRESENTATIVES
FEBRUARY 11, 2004

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 comprehensive postal reform. We have carefully studied the July 2003 Report of the President's Commission on the United States Postal Service. 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 under Chairman McHugh. 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.

In particular, we think that H.R. 4970 (McHugh/Waxman), a bipartisan effort introduced by Chairman McHugh late in the 107th Congress, and passed out of Subcommittee, provides a firm foundation for achieving the reform that stakeholders and the Presidential Commission are searching for, and that that legislation is consistent with the principles established by the Bush Administration in December 2003 that reform should :

Implement best practices
Create financial transparency
Allow for wider flexibility
Create more accountability
Continue the self-financing of the postal system

I. THE UNIVERSAL SERVICE OBLIGATION (USO)

PSA, as part of the mail order industry, is gratified and relieved that the President's Commission considered and rejected the illusionary panacea of privatization; revalidated the Postal Service's current mission, including six day 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. Reform legislation should recognize these important principles.

II. GREATER FELXIBILITY IN FIXING POSTAL PRICES AND SERVICES

PSA strongly supports giving the Postal Service greater flexibility to meet market conditions in the fixing of postal prices and services. USPS should 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 supports 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 strongly supports 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. Reform legislation should provide for streamlined procedures for negotiating and securing approval of NSAs.

III. DEREGULATON OF COMPETITIVE PRODUCTS

Of paramount importance to PSA is the total deregulation of 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 advocates 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.

Competition for the delivery of packages in the United States requires the Postal Service to continue to deliver packages as one of its core functions. That delivery market is highly concentrated. Packages, defined as parcels weighing one pound or more, are 97% concentrated among four carriers. United Parcel Service is far and away the market leader with 57% of that market, with the Postal Service lagging behind at 18%. The other two carriers are Federal Express and Airborne. In the sub-market of ground parcel delivery, as opposed to expedited transportation, there is even more market dominance, with a 78% market share for UPS, and only 7% for the Postal Service. This is the sub-market which describes parcel post. In this market, United Parcel Services delivers 3.82 billion parcels, and USPS only 381 million. If the Postal Service were to be legislatively prohibited from participating in the ground parcel shipment market, the UPS share would increase even more resulting in virtual monopoly domination of this market. With this type of market dominance, it is highly unlikely that the Government's anti-trust agencies would allow a merger of UPS with any other carrier in this market because of the even greater threat to competition. It would be ironic if Congress were legislatively to achieve a monopoly result for UPS, which government laws and regulations would otherwise prevent. Continuing the Postal Service's delivery of packages as one of it core functions is not only in the interest of the Postal Service, it is indispensable for promoting competition and giving consumers of package services a choice of carriers.

Package delivery service has always been 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. 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 believes 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. And it is pleased that the President's Commission agreed.

IV. RATIONALIZATION OF THE POSTAL SERVICE INFRASTRUCTURE

PSA strongly agrees with the findings and recommendations of the President's 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. REGULATION OF USPS

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 the President's Commission recommends be given to the regulatory body are excessive and, to the extent they interfere with purely management prerogatives or are broad policy making powers normally reserved to the Congress, are inappropriate. We disagree with the President's Commission that the proposed Postal Regulatory Board:

1. Should 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. Should 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. Should 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. Should 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 regulatory body make those final determinations with no review whatsoever.

Along the same lines, the regulator 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 regulator would embrace those standard definitions; but it may very well not, and that we would object to because, again, there is no independent review. The regulator should not be able, through fashioning its own definition of cross-subsidy, effectively to render the Postal Service completely non-competitive for all of its competitive product offerings in the real marketplace.

We think the provisions of H.R. 4970 to ensure against cross-subsidization of competitive products strike just the right balance between protection of users of monopoly services and protection of competitors from predation, and the USPS need to be competitive in the marketplace, both for its own interests and the needs of consumers to have more than one choice to deliver their products.

5. Should 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. Can avoid conducting trial type proceedings on any issue. 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 REFORM RECOMMENDATIONS

PSA also endorses:

- 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 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, the support of the Administration, 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. If that is the case, however, those extended reform efforts should not delay the 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 so 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,

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Dated: February 11, 2004

"Answering the Administration's Call for Postal Reform"

Special Panel on Postal Reform and Oversight
Committee on Government Reform
U.S. House of Representatives
February 11, 2004

Written Statement Submitted By:

Raymond J. Keating
Chief Economist
Small Business Survival Committee

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 to the Committee on Government Reform's Special Panel on Postal Reform and Oversight.

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.

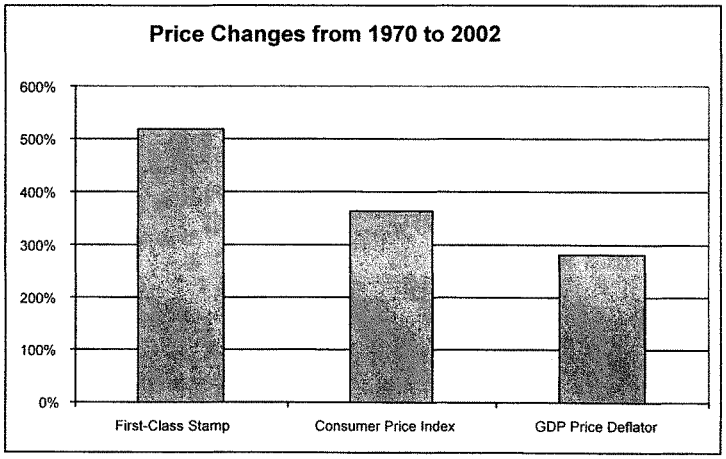
Thousands of businesses are now selling goods through online auction sites. An *Entrepreneur.com* article (September 2002) noted: "You really don't need anything but a computer, an Internet connection, a printer and a digital camera." A June 2002 "eBay Live!" gathering drew 5,400 sellers, and it was 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.

The President's Commission on the United States Postal Service drove home the point that the small business community relies heavily on the efficacy of the postal service: "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."

In the end, it's the business community that carries the burden of 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 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 is provided within a recent report "The Future of the Postal Service: Did the President's Commission Deliver for Small Business?"

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 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.

This issue of cost allocation and subsidizing competitive services from monopolized services needs to be dealt with for the benefit of both consumers and private-sector competitors. Rick Geddes of the American Enterprise Institute has noted ("Why We Need Postal Reform and What It Should Entail," March 17, 2003) that the 1970 Postal Reorganization Act "failed to reduce cross subsidies from monopolized to competitive mail classes, but rather appears to have exacerbated them." Another report from Michael Schuyler ("Uneven Price Markups Distort Postal Service Mission," Institute for Research on the Economics of Taxation, December 11, 2003) pointed out that "the markup is high on first-class mail (nearly double production costs) and much lower on most peripheral products. These unequal markups place a disproportionately heavy burden on first-class mail consumers, contrary to the government agency's mission." Schuyler added that with the Postal Service's claim of overhead costs, "non-core products may actually be losing money and receiving cross-subsidies from first-class mail customers to cover the losses."

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.

As long as 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 the Committee for providing us the opportunity to present our views on the Commission report. We were very pleased when leaders of the House Government Reform Committee issued a bipartisan statement on December 8, 2003, regarding the need for postal reform. They noted that "the Postal Service continues to be hampered by flagging revenue, high costs, and an untenable debt load. This crisis has been brewing for years, and it's time to act on comprehensive reform. Too many jobs, too many businesses and too many families are depending on us." SBSC certainly agrees with these sentiments, and 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.

Statement for the Record
Michael L. Eskew
Chairman and Chief Executive Officer, UPS
55 Glenlake Parkway
Atlanta, Georgia 30328

United States House of Representatives
Committee on Government Reform
Special Panel on the Postal Service
February 11, 2004

I appreciate the opportunity to present a written statement for the record expressing the views of UPS before the Special Panel on the Postal Service. The UPS Board of Directors is meeting today, February 11th, 2004, and, as Chairman of the Board, it is imperative that I attend.

The Administration offered guidance to Congress as it considers the broad and complex issues related to the United States Postal Service. In particular, I want to call attention to the request that Congress enact postal reform to ensure that the Postal Service "... operat[es] appropriately in the competitive marketplace." This criteria is critically important to UPS, and it is essential to ensure fair competition in competitive markets, which include Package Services, Priority Mail, Express Mail, and International Mail.

The timely and efficient distribution of core mail services, such as First-Class Mail, Periodicals, and Standard Mail, plays a vital role in this country and it is important that reform enable the Postal Service to be successful in this critical mission. My testimony covers four key points that UPS believes must guide legislative efforts to reform the Postal Service.

1. Postal reform must focus on core mail services.

The financial health of the Postal Service is determined by the performance of its core mail services, which consist mostly of First-Class Mail, Periodicals, and Standard Mail. Postal reform efforts must enable the Postal Service to succeed in delivering these services, and UPS wants to be supportive of these efforts.

Core mail services account for 86 percent of total Postal Service revenues and provide nearly all of the contribution to the Postal Service's "institutional costs." Because of the importance of these services to the Postal Service's financial performance, postal reform must concentrate on this segment of the business.

It is often argued that additional pricing flexibility on competitive services is essential to ensure the financial health of the Postal Service. However, this argument ignores the fact that competitive services generate only 14 percent of total revenues and account for only 8 percent of the contribution to the Postal Service's "institutional costs." Therefore, competitive services can not possibly solve the Postal Service's considerable challenges.

This view is supported by testimony given to the Presidential Commission by the Postal Service's CFO that showed that extraordinarily large increases in competitive volumes would be necessary to compensate for very small percentage declines in monopoly products.

It has also been argued that allowing the Postal Service to expand into new lines of business will provide additional revenue streams and solve the Postal Service's financial challenges. UPS strongly disagrees with this view. For example, the Postal

Service's own "non-postal" ventures have hurt, rather than helped, mailers and the Postal Service.

The Presidential Commission recommended that the Postal Service be given a focused, clear mission "to provide high-quality, essential postal services ..." (p. xi, emphasis added) The public is well served by private enterprises in all areas outside of core mail services, thus the focus of the Postal Service should be the timely and efficient distribution of core mail services.

2. Postal reform must include provisions to improve cost allocation and ensure transparent reporting.

Sound cost management is a critical component of the financial viability of any entity, and the Postal Service – as a *government* entity – is no exception. Therefore, postal reform must improve the quality of cost allocation and ensure transparent reporting. The Presidential Commission endorsed this position by saying that "... the Commission recommends that the Postal Service significantly improve its cost-allocation system." (p. 67)

In addition, the Administration spoke to the importance of product costing when it said that postal reform should be "guided by a set of clear principles" that address transparency to "ensure that important factual information on the Postal Service's product costs and performance is accurately measured and made available to the public in a timely manner."

Accurate cost allocation will allow the Postal Service to better identify the true cost of its services. In addition, transparent reporting is absolutely essential as long as the Postal Service is allowed to go to market with a government-granted monopoly.

3. Competitive products should not benefit from subsidies flowing from a monopoly network.

Postal reform legislation must ensure that the Postal Service's competitive products do not get a free ride on a monopoly network. If they do, they are receiving a subsidy from monopoly products that is not available to private enterprise.

The Postal Service's government-granted mail monopoly allows it to subsidize competitive products and unfairly compete with the private sector. Carrying competitive products on this network, when the cost of the network infrastructure has already been allocated to monopoly products, allows the Postal Service to unfairly leverage its monopoly network. Private carriers, on the other hand, do not have the luxury of leveraging a government-granted letter mail monopoly to compete in private markets. Instead, private carriers must recover all of their infrastructure costs from competitive product offerings. This is a significant advantage for the Postal Service when they participate in competitive markets, and one that is not recognized under current postal law.

UPS's concern about the pricing of competitive services can be illustrated by comparing the current pricing of competitive services to that of core mail services. Postal services are priced based on their attributable cost plus a markup. The markup on core mail services – which consist mostly of First-Class Mail, Periodicals, and Standard

Mail – is nearly two-and-a-half times as large as the markup on competitive services. This practice is inconsistent with how a government monopoly should be pricing its services, and it should be addressed.

In addition, the Postal Service also enters competitive markets with all of the advantages of a government agency, including exemptions from a variety of taxes and exemptions from other laws that apply to its private competitors. These governmental advantages are also not recognized in the current postal laws, and must be corrected.

UPS believes that addressing the subsidization of competitive products is at the heart of the Administration's call for the Postal Service to "... operat[e] appropriately in the competitive marketplace."

4. Postal reform must include a strong regulator.

A strong regulator must have the authority to: (a) ensure that prices for competitive products are free of subsidy, and (b) ensure that attributable costs are allocated correctly.

We cannot ignore the fact that the Postal Service goes to market with both a government-granted monopoly and with products that compete in competitive markets, which allows the Postal Service to charge a disproportionate share of its infrastructure costs to monopoly services and a relatively minimal share of those costs to competitive services. Therefore, additional pricing flexibility should not be permitted.

In addition, the Postal Service is a government entity with a public-service mission. This unique status requires that a strong and independent regulator exist to protect customers from the exercise of monopoly power.

Finally, the current 10-month rate-setting process is often criticized as unreasonably burdensome. This process can be improved and streamlined, as UPS testified to the Presidential Commission. However, improvements to the rate-setting process should not be confused with arguments for pricing flexibility.

A strong regulator must ensure that the prices for competitive products are free of subsidies from a monopoly network and that costs are allocated to each service appropriately. It is also necessary that the regulator be granted the powers to ensure transparent reporting. This is simply the price of going to market with a government-granted monopoly.

Closing

The President's Commission on the United States Postal Service did an admirable job examining the challenges facing the Postal Service, and developing a vision for its future. UPS was an early proponent of the Commission and played an active, participatory role in the Commission process. I testified before the Commission, as did James Holsen, our Vice President of Engineering. Additionally, as the Commission saw fit, we provided ancillary documents and made our staff and facilities available. I also appreciate the steadfast efforts of Panel Chairman John McHugh and Committee Chairman Tom Davis for their continued efforts on this complex and critical issue, especially their joint effort with Panel Ranking Democrat Danny Davis and Committee Ranking Democrat Henry Waxman. Additionally, I want to commend Postmaster General Potter's focus on efficiency and cost control and the overall financial improvement of the Postal Service that has occurred under his leadership.

The U.S. economy is built on the principle of free enterprise. It has not been the role of government to move into areas that are well-served by highly competitive, private companies.

However, the Postal Service's core mail services – which consist mostly of First-Class Mail, Periodicals, and Standard Mail – play a vital role in this nation. In particular, UPS recognizes the role that the Postal Service's core mail products play in facilitating commerce, and it is important that reform enable the Postal Service to be successful in this critical mission.

UPS believes that legislative efforts to reform the Postal Service must address four key issues: (1) focus on core mail services; (2) improve cost allocation and ensure financial transparency; (3) ensure that competitive products do not benefit from subsidies flowing from a monopoly network; and (4) strengthen regulatory oversight.

I look forward to continuing to work with Congress, the Administration, and the postal community on this important issue.

®

March 12, 2004

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Hon. John McHugh
Chairman
Special Panel on Postal Reform and Oversight
Committee on Government Reform
House of Representatives
2157 Rayburn House Office Building
Washington, DC 20515-6143

Dear Representative McHugh:

Thank you for the kind invitation you extended to Gary Mulloy, ADVO's Chairman and CEO, to testify before the Special Panel on February 11, 2004. Mr. Mulloy was honored to appear before the panel and hopes that his testimony was helpful.

Along with this letter, I am FAXing our answers to the questions that Members posed to other witnesses. I would respectfully request that they be included in the record of the hearing.

Thanks again for all your work on behalf of the cause of postal reform. The Postal Service is a national treasure, and we know you will do everything in your power to protect and strengthen the institution that is so important to the life of our nation.

Sincerely yours,

Patrick J. Flaherty

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Total FAX 8 pages including this one

First Panel Questions
House Government Reform Committee
Postal Hearing
February 11, 2004

Congressman McHugh: If you could list one, or two, or three at the outside, must-haves in terms of any piece of reform legislation, which would you pick?

Answer: The top priority must be to promptly stabilize the USPS's balance sheet through comprehensive reform of the Postal Service's pension and retiree health care funding.

1. The allocation of the pre-1970 pension obligations should be returned to the method used before last year.
2. The military and government service portion of pension obligations should be shifted back to the Treasury where it belongs. On this point, I would note that no other business in America is required to count prior military service or volunteer service time (Peace Corp, Vista, etc.) in their private pension plans.
3. A portion of the funds put in escrow as part of last year's legislation should be used to extend rate stability beyond 2006.

A second priority is that the Postal Service must be given more pricing flexibility. The USPS operates in a fluid and fast changing marketplace, and it must be able to adapt. One mechanism for this is increased use of contract rates (negotiated service agreements) that stimulate increased use of postal services through volume, frequency and flexible payment term incentives.

Congressman Davis (IL): I notice that the President's Commission recommends that the USPS should meet the highest standards of corporate leadership, including a strong board of directors guided by the best business practices. We have talked about that a bit in terms of how we move the Postal Service towards becoming, as we have described, a business. What are those best business practices that they may be talking about?

Answer: The best businesses have the top goal of making profit over the longer-term. No business can survive in a competitive environment unless it can provide useful products and services at prices demanded by the market. The best businesses adapt to changing market conditions, the rest fail. They also have a realistic, vetted, strong business strategies and implementation plans that pursue those strategies with policies such as the following:

- Improve performance and accountability of people with a focus on recruitment, development and retention of superior talent.
- Continuing management and operational analyses to improve efficiency and quality
- Effective, efficient and flexible management of all resources

- Efficient planning and integration of business operations (and potentially other activities) with those of customers
- Utilization of new, proven technologies all along the supply chain and in the development of new products and services
- Efficient capital investment process and maintenance of adequate capital for investment and reserves
- Recognition and funding of costs as they occur
- Financial profits and clarity for shareholders (clean, uncomplicated, explained, audited financials)
- Research to fully understand customers and competitors

A good business frequently reviews and improves its strategic plan to reflect and take advantage of changes that occur in the business environment.

Those leading the Postal Service, whether as Governors or Directors, and those regulating it, whether as Commissioners of the Postal Rate Commission or a Regulatory Commission, should be individuals with proven management skills and experience.

Congresswoman Miller: I think this question is to Mr. Critelli from Pitney Bowes. My family was in the marina business and I remember 35 years ago when we got our first Pitney Bowes meter, and I just thought that was the coolest thing ever. That was my job to go down to the Post Office once a week and get that meter filled up and give the postmaster a check and you get your little red ink and fill all that up. Now it seems so unbelievable antiquated, but it was great at the time. You talk about 35 years and what has changed. Could you expand a bit on what kinds of technology is happening in your industry and how it is positively impacting? It has the potential to positively impact the postal services. You have talked about intelligent mail. Who has to do what to make I-mail a reality?

Answer: The Postal Service is attempting to increase the value of the mail-stream through greater tracking and other capabilities. These enhancements will benefit users of the mail and may help the Postal Service grow or retain business. However, not every problem has a technological solution. Where automation or other enhancements truly gain efficiencies, lower costs, or enhance value they should be supported. However, unless the Postal Service is given the ability to effectively deploy its employees and manage its resources, technological investments will not deliver the expected efficiency gains. Similarly, if the Postal Service is not able to price its products and services to meet the demands of a competitive market, enhancements and innovations will not bring new revenue to the Postal Service. If "I-mail" is overpriced, business will continue to go elsewhere.

Congresswoman Miller: You mentioned about dynamic pricing. And having the flexibility given to the Postal Service to be able to change pricing at a very quick rate, I suppose. Many of you have testified about how important it is as you are doing your business modeling to have a cap, have predictability. I am just trying to understand what

you are saying. If I were to give the Postal Service the ability to change prices very quickly, wouldn't that negatively impact the private sector's ability to do their modeling?

Answer: Currently it takes the Postal Service nearly 2 years to change rates – months of planning and preparation within the postal service as they prepare to file a rate case, and then months of litigation once a case is filed. This process does not give the Postal Service the ability to respond to market conditions. "Flexibility" does not necessarily mean rapid change; it can mean a thoughtful, carefully planned response to the market. There are seasonal fluctuations in mail volume, and some days of the week are heavier than others. Other industries are able to respond to these factors through pricing: for example, a movie theater might charge a lower rate for a Wednesday matinee than for a Saturday night showing of the exact same movie. Airlines might charge a different rate if you want to travel to Europe in the winter than in the summer. Finally, we have long advocated greater use of contract rates (or negotiated service agreements) as a way to achieve flexibility *and* the ability to plan for both business and the Postal Service.

Congresswoman Maloney: All of you have testified in support of postal reform. What would happen to your business if you did not get it, say, in the next year? What would be the impact on your business, if any?

Answer: They key result from a lack of postal reform is an unnecessary increase in rates. Increasing rates has a negative impact on both the Postal Service and its customers. For the Postal Service, the problem is one of the oft mentioned "death spiral," increasing rates leading to decreasing volume and further rate increases. For customers, it can lead to a loss of business and jobs in an industry that makes up a significant portion of the nation's economy. In the case of ADVO, it can lead to a diversion of business away from the Postal Service. ADVO is already using private carriers in three markets because the cost is substantially below the cost of postage. This is not our goal – we would prefer to stay in the mail, but current postal rates are already non-competitive and the expectation of further excessive rate increases may give us no choice but to expand this program.

Congresswoman Maloney: I am also concerned about the number of magazines that folded in the District that I represent. What were the dynamics involved with the decisions for some that had been around for 75 years or more?

Answer: We at ADVO can sympathize with the plight of the magazine industry because we know that larger and small retailers are mailing less solo mail. The postage cost of mailing a circular is just in the ballpark of alternative distribution which is often 1/6 to 1/3 the cost. As noted in our previous answer, we are already using private carrier delivery services because of the cost savings to the company and if the cost of postage increases, we will have to consider expanding that program.

Congresswoman Maloney: What does your company do in response to the increasing price of postage?

Answer: As I mentioned, ADVO is already using private carriers in three markets because the cost is substantially below the cost of postage. We are forced to consider expanding our alternate delivery services, and thus taking business away from the USPS. Price stability, however, would allow the $900 billion, 9 million person mailing industry to reinvest in itself, creating more volume and business for the Postal Service.

Congresswoman Maloney: You all mentioned that if they had an outside governing board that would be open to having ideas, but how would you make that happen? All of you would be great on it, but you probably wouldn't have time to do it. So you are recommending something that is hard to implement really. The Postal Service could use some ideas.

Answer: ADVO would be happy to help in any way possible. The problem is the regulatory regime under which the Postal Service currently operates. No matter how experienced, knowledgeable, and motivated board members may be, if they are tied by substantive regulatory constraints, they cannot implement adequate change. Indeed, most such potential desirable board members would refuse to serve under those circumstances. Thus, reforms similar to those suggested by the President's Commission and that are being considered by this Committee are necessary to create the ability to adapt to changing market conditions necessary to encourage the growth of business. Potential desirable board members would then see that they would have a real opportunity to respond to the challenge of making needed improvements.

Congresswoman Blackburn: Mr. Morris, your negotiated service agreement, you mentioned the amount of time and energy that went into that. Last week when we had our hearing, we talked at length about the lack of an updated business model for the Postal Service, and the fact that this has gone 30 years without attention, which is a shock for many of us who have come from the private sector and the opportunities that exist for the Postal Service that we would like to see them take advantage of in creating a more businesslike model for their operations. In establishing your NSA, did you reach out to the Postal Service and initiate the contact or did they come to you and suggest?

Answer: Speaking for ADVO, we have been talking about NSAs for years. For example, in 1989 we filed a petition to initiate a rulemaking proceeding to establish procedures for consideration of contract rates. While the question of who approached who first is of some interest, the fact is that many of us in the industry and in the Postal Service have been talking about this concept for many years, because both parties see the advantage of it. However, the business model prescribed by the statutory framework makes it extremely difficult and time-consuming to reach successful agreements. We supported approval of the CapitalOne agreement and hope that many more agreements are achieved in the future. The ability to enter into NSAs is a substantial and irreplaceable tool that the USPS can use to not only reduce its costs but also to retain and grow its volumes and revenues. Not having NSAs or contracts with its customers puts the USPS at a serious disadvantage with its competitors who all use contracts and offer volume and frequency incentives to retain and grow business.

Congresswoman Blackburn: Last week, we talked some about the Postal Service expending over 80 percent of their revenues on labor costs and looking at their labor costs. What does your company spend on labor?

Answer: Labor costs are 21.2% of ADVO's total revenue. Since approximately half of our revenue is postage, labor is just over 40% of our non-postage costs.

Congressman Schrock: Everyone is asking about price stability and pricing flexibility, but how do we give the post office more ability to change their rates, but give the customers the predictability they need? And it can be based pretty much on an inflation-based cap?

Answer: If the USPS is released from the excessive payments it has been making for retiree benefits and given the freedom to flexibly manage its resources, pursue efficiency improvements, and retain profits, there should be no reason why it can't keep rate changes below the rate of inflation or even offer rate decreases.

An inflation-based rate cap is a good mechanism for managing rate changes. But, for the rate cap mechanism to work effectively for a reformed USPS, there are certain technical aspects that must be incorporated, for example:

- Setting baseline rates that reflect current market and demand differences among mail products and services
- Exempting competitive products and services from the rate cap process
- Permitting flexible rate changes within a grouping of products and services subject to an overall cap

Congressman Schrock: How can USPS most effectively partner with private mailing companies to lower costs and improve efficiency?

Answer: While of course there are many opportunities to improve, it is important to recognize that the Postal Service partners with its customers every day. Discounts for sorting and bringing the mail to the most cost-effective entry point have helped the Postal Service and the industry gain efficiencies and lower costs. The process should continue and be supplemented by the efficient use of NSAs. Through its rates the Postal Service can offer incentives to its customers to retain, grow volume and frequency and present the mail in the most efficient manner.

Congressman Schrock: What do each of you think universal mail service is? What is universal?

Answer: Universal service is the ability to daily reach every household and business. If universal service is reduced as a cost saving measure, the Postal Service's viability will

be weakened. The Postal Service is of value to the mail industry because it delivers our advertising messages to every home six days a week without charge to the recipient. The Committee should reject any steps that would weaken the relationship between the American people and their mail. To the contrary, the bond should be strengthen, *e.g.*, the timing and frequency of daily delivery and the expansion of delivery to seven days. Five percent of ADVO's packages are delivered on Saturday (none on Sunday). We estimate that over 60% of preprint advertising material is delivered on the weekend, primarily via newspapers and other delivery options.

Congressman Clay (to Mr. Smith): The Postal Service is not a government entity, but also not a private entity. Instead, a number of special laws govern its operations, such as a statutory mandated rate-setting process and a requirement that the USPS break even. What are some of the biggest handicaps the postal service faces that we need to change?

Answer: The Postal Service faces several severe handicaps. The constraints on the USPS ability to effectively and efficiently manage its resources and set the conditions under which it offers its services are also major handicaps. Greatly exacerbating those constraints is the fact that the USPS has been required to overfund its pension obligations, and has hard to charge its consumers and customers excessive rates in order to do so. Overpayments into the CSRS system now total approximately $81 billion. This is money that has been taken from Postal Service consumers and customers and paid to the general Treasury. When these overpayments were discovered, instead of acknowledging these overpayments fully and working to help make the Postal Services and its customers whole, the Treasury supported a change in the actuarial method for allocating benefit costs for employee service done prior to the 1971 creation of the Postal Service and transferred responsibility for funding benefits for time spent in military and other federal service to the Postal Service. The Congress should return to the former allocation method, remove responsibility for military benefits, release the funds currently scheduled for escrow under Public Law 108-18, and recognize that the Postal Service has already funded all of its debts, and liabilities including retiree health care. This will rescue the Postal Service from a serious handicap that has hindered its growth.

Congressman Clay (to Ms. Moore): You indicated that the current business model of the USPS is not sustainable. Would you explain your reasoning on that statement?

Answer: The current USPS business model was designed in 1970 and depends entirely upon a full postal monopoly and a substantially growing postal demand. However, neither condition is present now – the USPS has competition in all of its product and service markets and postal demand growth is sluggish if not entirely stagnant. For some major services, demand is actually declining.

The USPS now needs to be relieved of its overpayments for retiree benefits. It also needs to be able to effectively, efficiently, and flexibly manage all its resources so that it can get its costs to more rational, competitive levels. Finally, it needs to efficiently manage its

demand by flexibly pricing its products and services based on both efficient costs and current market conditions.

Congressman Clay (to Mr. Critelli): Mr. Critelli, your statement indicated that the USPS' mission needs clarification to be accomplished. Do you feel there is ambiguity in the current mission statement?

Answer: The mission of the Postal Service has always been to serve America's hard-copy communications and commerce needs. That includes everything from regular first class mail to periodicals to advertising. All of the things the Postal Service does to support commerce, including mail advertising are vital to hundreds of thousands of American businesses and to the American economy. The Committee should oppose any efforts to limit the ability of the Postal Service to perform these important functions.

USPS competition is beneficial for consumers and large and small businesses. Congress should preserve competition and protect competitors from competition.

Congressman Clay (to Mr. Davis): Mr. Davis, you talk about the importance of service performance standards. What kind of performance standards?

Answer: For the Postal Service, performance standards are quite simply the predictable and reliable delivery of mail. The vast majority of ADVO's mail programs have a two-day in-home date window, with approximately 98% of our mail being delivered in those two days. We would like to see that number get closer to 100%, a goal that we think is achievable. In fact, because at our own considerable expense our mail is walk sequenced by carrier route and delivered directly to the delivery unit, we believe that day-certain delivery should be an attainable goal without drastic increases in cost or rates.

Congressman Clay: Please explain why the Postal Service should be allowed to focus on its core competency, which is universal service. Shouldn't the Postal Service look for additional innovative revenue enhancement opportunities?

Answer: The Postal Service should focus on its core mission – its core competency of delivering hard copy to American homes and businesses. The Congress should not prohibit all other activities: the Postal Service has traditionally provided other services over the years: passports, money orders, and even a location where young people register for the draft. Of course, the Postal Service should consider any new venture with extreme caution. New ventures are by definition risky. If a company risks its own capital by going into a new venture, the stockholders bear the risk of failure, a failure that could jeopardize the core business as well. The Postal Service cannot afford that kind of failure, so it should not be taking that kind of risk.

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