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POSTAL REFORM: SUSTAINING THE NINE MILLION JOBS IN THE $900 BILLION MAILING INDUSTRY

HEARINGS

BEFORE THE

COMMITTEE ON GOVERNMENTAL AFFAIRS UNITED STATES SENATE

ONE HUNDRED EIGHTH CONGRESS

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MARCH 9 AND 11, 2004

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POSTAL REFORM: SUSTAINING THE NINE MILLION JOBS IN THE $900 BILLION MAILING INDUSTRY

TUESDAY, MARCH 9, 2004

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

The Committee met, pursuant to notice, at 10:04 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

Present: Senators Collins, Durbin, and Carper.

OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. Good morning. The Committee will please come to order.

Today marks the fifth in a series of hearings that the Committee is holding to review the recommendations made by the Presidential Commission on the Postal Service. Under the effective leadership of Co-Chairmen Harry Pierce and James Johnson, the Commission put together a comprehensive report on an extremely complex issue, identifying the operational, structural, and financial challenges facing the U.S. Postal Service. The Commission's recommendations are designed to help this 225-year-old Postal Service remain viable over the long term.

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

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

At our first hearing last September, the Committee heard from President's Commission on the U.S. Postal Service Co-Chair Jim Johnson. Mr. Johnson made the very important point that the

Postal Service's short-term fiscal health is illusory and that Congress must not ignore the fundamental reality that the Postal Service, as an institution, is in serious jeopardy.

The Presidential Commission presented its assessment of this crisis in frank terms, concluding, "An incremental approach to the Postal Service reform will yield too little too late, given the enterprise's bleak fiscal outlook, the depth of current debt and unfunded obligations, the downward trend of First Class Mail volumes, and the limited potential of its legacy postal network that was built for a bygone era." This is a very strong statement and it is one that challenges both the Postal Service and the Congress to embrace far-reaching reforms.

At the Committee's second hearing in November, we heard from the Postmaster General and the Comptroller General. The Postmaster General described transformation efforts already underway at the Postal Service, many of which are consistent with the Commission's recommendations. He also testified, however, that legislation was required in order to accomplish many of the other recommendations.

In his testimony, Comptroller General David Walker of the General Accounting Office shared the Commission's concerns about the Postal Service's $92 billion in unfunded liabilities and other obligations. He pointed to the need for, "fundamental reforms to minimize the risk of a significant taxpayer bailout or dramatic postal rate increases." In fact, since April 2001, the Postal Service has been listed on the General Accounting Office's high-risk list.

More recently, the Committee heard from representatives of the four largest postal unions, the Postmaster and Supervisor Associations, the former Director of the Federal Mediation and Conciliation Service, plus two experts on the issue of postal pay comparability. The Commission's workforce-related recommendations were discussed at length during those hearings.

Today, we will focus not only on the workforce and financial recommendations, but also on the Postal Service's monopoly and mission, the rate setting process, and corporate governance issues. Among these recommendations are proposals to grant a new Postal Regulatory Board the authority to refine the scope of the monopoly and also to issue standards defining the scope of the universal service application. I would note that it is my judgment that many of those issues are best reserved to Congress rather than being vested in a new regulatory board. The Postal Regulatory Board would also be granted the authority to transfer the existing rate setting process into an incentive-based rate ceiling system.

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

If the Postal Service were no longer to provide universal service and deliver mail to every customer, the affordable communications

link upon which many Americans rely would be jeopardized. Many commercial enterprises, indeed, most of them, would find it uneconomical if not impossible to deliver mail and packages to rural Americans at the rates charged by the Postal Service.

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

Senator Carper and I have committed to working together with many other Members of this Committee to draft a bipartisan postal reform bill. Now, given the history of previous attempts at legislative reforms, I know that this will be a daunting challenge. It is not coincidence that the last reform was done more than 30 years ago. But it is essential if we are to preserve the Postal Service into the 21st Century that we seize the opportunity presented by the Commission's excellent work.

I welcome our witnesses today who are from the mailing community. We will hear a variety of views and insights on the recommendations of the Presidential Commission and I am pleased to welcome our first panel of witnesses today.

Ann Moore is the Chairman and the Chief Executive Officer of Time Inc. In this position, Ms. Moore oversees all of the businesses of Time Inc., which is the world's leading magazine company and a leading direct marketer of music and videos. Her work at Time, Inc. has earned her numerous awards and honors, including her appearance on *Fortune magazine's* list of the 50 most powerful women in American business.

Mark Angelson is the Chief Executive Officer of RR Donnelley. I would note that he has held that position for all of 9 days, but we are very pleased that he could be with us today. Mr. Angelson assumed his new position when RR Donnelley and Moore-Wallace Corporation combined, creating the new RR Donnelley, which is the largest printer in North America. Prior to this position, Mr. Angelson was the Chief Executive Officer of Moore-Wallace, Incorporated, the third-largest printing company in North America and was the principal architect of the merger.

We are very pleased to welcome both of you here today. We know you are both extremely busy individuals and I think it demonstrates just how important postal reform is that both of you, as CEOs of major corporations, would take the time to be here today.

Ms. Moore, we will start with your testimony.

TESTIMONY OF ANN S. MOORE,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER, TIME INC.

Ms. MOORE. Thank you very much, Chairman Collins, for this opportunity to discuss the crucial issue of reforming the U.S. Postal Service. As you said, 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,* and *Sports Illustrated.*

I have been involved in postal reform for a long time. I actually volunteered to work on this back when I was President of *People* magazine because there is no issue that is more crucial to the mag-

[1] The prepared statement of Ms. Moore appears in the Appendix on page 69.

azine 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, so we need to work together to ensure that this can continue over the long term. It affects everyone, 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 and business. We know that Congress wants to maintain this goal and we have this wonderful opportunity to pass a meaningful, comprehensive reform bill and we are committed very much to getting this done.

The current Postal Service business model is not sustainable, as we all know, in a climate of expanding addresses and declining mail volume, and we applaud the efforts of Jack Potter to reduce Postal Service costs. But reducing costs alone won't solve the problem. Broad and sweeping reform is required.

President Bush and the Treasury deserve thanks for creating the Presidential Commission to help address these issues and we completely support the report's five core principles.

We also 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 and we feel that mediation arbitration might bring parties closer to an equitable resolution while protecting the interests of the employees and the Postal Service.

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 often surprises people, but this year, we will spend more than $500 million on postage. We actually spend more on postage than we do on paper or printing. We spend more on postage 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 testimony. 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. This is 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 the problem. That is why Congress needs to institute a rational rate cap system.

Today's rate system fails to provide the Postal Service with strong incentives to hold down costs, too. It also fails to provide mailers with predictable rates. Give us predictable rates and we will give the Postal System more volume, from our current magazines to all the new ones I would really like to launch.

We have a lot of 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 costs of a new launch, the risk of building a new magazine is too great. I don't need to tell you that ventures like new magazines create jobs at Time Inc. and beyond. While I have 15,000 employees at Time Inc., you could count all the

suppliers that depend upon us, from the paper mills in Maine to the printers to the mail houses. There are many jobs at stake. So for all of these reasons, it is crucial that rates be capped to an inflation benchmark.

Now, of course, rate caps must not be met at the expense of good service, so any reform bill must also include service measurement systems and delivery standards for all classes of mail. In addition, rates need to be based upon cost and include the proper incentives for mailer work sharing. This concept provides the Postal Service and the mailing community an incentive to seek the lowest possible cost and the highest quality service.

Before I conclude, I want to comment on last year's CSRS legislation. This bill provided much needed relief for the mailing industry. Thank you for getting it passed. That said, the bill has two problem items that need to be addressed.

First, the bill's escrow provision will force mailers to pay an additional $4 billion to the Postal Service in 2006. This item alone will add another 5.4 percent increase to postage rates.

Second, the CSRS bill also shifted $27 billion in military retirement costs from the Treasury to the Postal Service. Since approximately 90 percent of these costs date back to before the establishment of the Postal Service in 1971, these military costs are not really the responsibility of the people who rely on the Post Office.

So in summary, Time Inc. believes that the issues challenging the Postal Service are urgent and demand action by Congress and the Postal Service. We need three things: Predictable rate increases that do not exceed the rate of inflation, resolution of the CSRS escrow and retirement issues, and 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. Thank you again, Madam Chairman, for this opportunity to share the views of Time Inc. with this Committee.

Chairman COLLINS. Thank you for your testimony.

Before hearing from Mr. Angelson, I would like to give my two colleagues a chance for any brief opening comments that they might want to make. Senator Durbin.

OPENING STATEMENT OF SENATOR DURBIN

Senator DURBIN. Thanks a lot, Madam Chairman, and I will take your advice to make it brief. I want to welcome both of our witnesses, Ms. Moore as well as Mr. Angelson. Of course, he is with RR Donnelley, which is a major employer in Chicago, a city that I am honored to represent, new to the job a few days, and happy to have you here.

Ms. Moore indicated that Time Inc. is one of the largest customers of the Postal Service, and I know that RR Donnelley is the company that is the largest private user of the U.S. Postal Service. I think that is why this particular hearing is so important, so we can understand not only the reform of the Postal Service, on which the Chair has been our leader, but also its impact on private business and how we can try to develop some synergies and try to make it more efficient.

So I thank both of the witnesses for coming. Particularly, Mr. Angelson, thank you for the great work that RR Donnelley does in the Chicagoland area, all around the United States, and the world.

Thank you, Madam Chairman.

Chairman COLLINS. Thank you. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Just a quick note to say welcome. Thank you very much for making time out of your day and week to join us and to share your testimony with us.

We are attempting to undertake here something that hasn't been undertaken for over three decades, and that is to try to figure out what our Postal Service should look like going forward. As we attempt to design and develop and build a consensus around the Postal Service in the 21st Century, your input is welcome.

I just want to say to the Chairman, this is not the last but one of many in a very helpful series of hearings that enable us to learn and hopefully will bring us a step closer to consensus. We will find out just how successful we have been in that in a month or two, so thanks very much.

Chairman COLLINS. Thank you. Mr. Angelson.

TESTIMONY OF MARK ANGELSON,[1] CHIEF EXECUTIVE OFFICER, RR DONNELLEY

Mr. ANGELSON. Madam Chairman, thank you for inviting RR Donnelley to testify this morning and good morning to you. Thank you, Senator Durbin from the great State of Illinois, where we live and are headquartered. Senator Carper, from the great State of Delaware where we are incorporated, thank you for having us this morning.

Chairman COLLINS. And so what are you doing for Maine? [Laughter.]

Mr. ANGELSON. We are buying more paper than you can possibly imagine.

Chairman COLLINS. I thought that might be the answer. [Laughter.]

Senator CARPER. I think that covers all the bases here. [Laughter.]

Mr. ANGELSON. I am Mark Angelson, Chief Executive Officer of RR Donnelley. Thank you for the slack that I hope you will cut me for the fact that this is day nine on the job. Thank you very much. And while I have always known that a healthy, viable, and most important, affordable Postal Service is essential to our country and to our economy, when I found out 9 days ago that it costs our customers more to mail a catalog or a magazine than it does for us to manufacture it, I knew it was important that I be here with you and with our fine customer, Ms. Moore, this morning.

As you may know, RR Donnelley is the largest commercial printer in North America and perhaps in the world. As a result, that makes us one of the largest, if not the largest, users of the U.S. Postal Service.

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[1] The prepared statement of Mr. Angelson appears in the Appendix on page 75.

In addition to being a printer, we also enter nearly nine billion pieces of printed material into the mail each year, including magazines, catalogs, direct mail, telephone bills, and other highly personalized statements on behalf of customers, customers like Ms. Moore, who sits beside me this morning.

Our employees and our customers see, feel, and experience every single day the consequences of a Postal Service in bad need of reform. RR Donnelley fundamentally supports the recommendations of the President's Commission and we urge Congress to push ahead now with the necessary changes. If we continue to put off reform, we will no longer be in the advantageous position of passing thoughtful, comprehensive reform, but may, in fact, be in a position where we have to respond to a crisis.

Change is essential to the health of the U.S. mailing industry as a whole. I know that you have heard these numbers before, but I find them so compelling that I feel impelled to say them again. This is a $900 billion industry which accounts for 9 percent of the gross domestic product and nine million jobs.

Just a short word, if I may, about jobs. At a time when many manufacturing jobs are at high risk of moving abroad, I am as sure as I am that it will be dark tonight and light tomorrow morning that your local letter carrier's job will never move overseas. Reforming the Postal Service, therefore, is also an opportunity to strengthen a sector of American jobs that stay in America.

This hearing today, therefore, is about much more than reforming the Postal Service. It is about the economy, it is about jobs, and it is about the future.

The postal distribution system as it stands today is inefficient. The President's Commission recognized these inefficiencies and now recommends changes. I hope that you will agree with the Commission and with RR Donnelley and our fine customer that there is substantial potential for improvement here and that the time to do it is now.

Any piece of legislation, though, that protects the status quo will not be sufficient and will not be acceptable under the circumstances. At its heart, the Postal Service must change. Respectfully, it must change to allow, to encourage, and better yet, to demand ongoing improvement. In doing so, the Postal Service can function more like a business to the benefit of everyone involved. When I say more like a business, let me hasten to add we are not talking about losing jobs for people. We are just talking about using common sense.

With my limited time, I would like to focus on just three areas, work sharing, network optimization, and the civil service retirement issue.

In today's world where technology is constantly changing to allow for new improvements, no company can do everything. As a result, we have all learned to focus on our core competencies and to rely on others and their expertise in order to maximize our performance. The Postal Service should do this, too. Delivering the mail to and from every address in the United States 6 days a week, otherwise known as universal service, is the USPS' core competency. It is simply what they do best. All of the rest, I suggest respectfully,

should be left to those who can do it better, and this combination is what we call work sharing, as you know.

Work sharing frees up the Postal Service to focus on its core competency while having others, such as RR Donnelley, focus on the non-core competencies. This highly effective combination drives down cost. In fact, according to the General Accounting Office, in 1999 alone, work sharing saved the USPS an estimated $15 to $17 billion. Yet, and this is a very important point, even though there is proof that this works, it is as difficult today to enter into a work sharing agreement with the Postal Service as ever before. It is simply not a widely accepted practice.

Let me give an example. RR Donnelley and others recently reached an agreement with the USPS on co-palletization. The deal took 18 months to reach, and in the end, all we were granted was a 3-year trial. That same deal, if I were to try to make it with a typical private sector partner, would have taken 4 weeks, 6 weeks, or 8 weeks. We shouldn't have to work this hard to persuade our partner at the Postal Service to reach a result that benefits customers, that benefits the U.S. Treasury, the Postal Service, and, therefore, all users of the system.

The second subject that I would like to address is network optimization. It is inconceivable to me that there have not been ongoing adjustments in the USPS network, but there haven't been. The Postal Service's current distribution network was established over 30 years ago and it has remained virtually unchanged ever since. That is astonishing when one thinks about the changes that have occurred in that same period, changes that have had a direct impact on how we use and how we would like to use the USPS. From major trends like population shifts to the invention of E-mail, the country is different now, but the USPS remains the same, and respectfully, I would urge you that that has to change.

The USPS must be allowed and incentivized to keep pace with change. Facility locations, size, and transportation routes should be changing constantly to keep up with demand, to eliminate redundancy and overcapacity, and to achieve productivity gains. All successful businesses constantly adjust to changes in customer traffic, demographics, and other factors, especially service businesses like the USPS.

Put simply, the USPS must be allowed constantly to realign its network to reflect current realities, free of emotion, and respectfully, Senators, free of politics. If changes of this nature are not an ongoing, unencumbered process, all the legislation in the world will not make the Postal Service run better, nor more smoothly, nor more efficiently.

Work sharing coupled with network optimization makes it possible to achieve what we call the lowest total cost. This concept is at the core of what RR Donnelley and our fine customers hope to have from the USPS.

And a final word on the civil service retirement problem. First, I ask respectfully that Congress consider removing the CSRS savings escrow requirements that were created last year. Doing this will free up approximately $73.3 billion that the Postal Service can use to pay down its debt to the U.S. Treasury and to hold postage rates steady, among other things.

Second, there is no good reason for the Postal Service to bear the financial burden of the civil service military retirement benefits. No other Federal agency is required to do this. If the Treasury doesn't assume these costs, the result is simply that the costs will immediately be imbedded in the price of a stamp. In other words, mailers, not just RR Donnelley and Time Inc., but many small businesses and American families inappropriately will be paying these retirement costs. Let us not make the job of the Postal Service even more difficult by keeping this financial burden on its back, please.

We have a chance right now, a real opportunity, to make the necessary changes to assure that the U.S. Postal Service and the mailing industry as a whole remain healthy and viable. Several more years of business as usual could bring us to a point of dangerous disrepair.

I thank you for the honor and privilege of appearing before you this morning. Thank you very much.

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

I am very pleased that you reiterated the startling statistics about the impact of the Postal Service on our Nation's economy and on some nine million jobs. One of the witnesses on our second panel, a catalog owner from Maine, was the one who first told me about that impact and I think most people are startled to realize that the Postal Service has such an economic impact.

When I look at both of you, you really represent that impact. *Time* magazine buys paper from a mill in Bucksport, Maine. You print on that paper. The interrelationship between the paper manufacturers, the printers, the publishers, and the ability for you to buy lots of paper from a Maine mill depends directly on affordable, reliable, and predictable postal rates, and I think in the debate that we can't lose sight of the fact that if the Postal Service's rates soar or become completely unpredictable, that it is going to have a negative impact on both of your operations and on those paper mills back home in Maine.

Could you comment, Ms. Moore, on the economic impact of unpredictable and high postal rates on *Time* magazine?

Ms. MOORE. Whenever we have had an unpredictable postage increase, we first scramble to do everything we can within our own business formula. That might mean reducing the size of the magazine. We have had wonderful paper suppliers who have done a miraculous job of lowering the weight of paper. The technology improvements out of the paper industry have been really just fabulous. But those things we can do internally to our physical products only can go so far.

With three price increases, we really had to scramble to cut back on mailings, on volume. It prevents us from launching new magazines, and then ultimately, we have to pass that price on to our reader, and it has not been a welcome increase over the last 3 years.

Chairman COLLINS. Mr. Angelson.

Mr. ANGELSON. I would add very briefly, Madam Chairman, that when Time Inc.—when postage rates go up and Time Inc., and others mail less, we print less and the impact on jobs that we are trying to avoid is, in fact, compounded in the other direction.

Chairman COLLINS. Thank you. Some of the most controversial recommendations made by the Commission have to do with the Postal Service's workforce. Now, I don't support personally all of those recommendations, but I do believe that we cannot ignore the workforce issues given that 75 percent of the Postal Service's costs are directly related to its workforce.

You have both stressed in your statement the need to deal with the escrow account and the military pension issues, which I completely agree with. Senator Carper and my bill last year did not have the escrow account in it. That was added on the House side and I, for one, am committed to reversing that provision.

But those are only two of the issues that affect the workforce. Ms. Moore, if we are going to be serious about tackling postal reform, can we ignore those workforce recommendations?

Ms. MOORE. It is not possible to have meaningful postal reform without addressing the labor issues, and I view labor, however, as a key partner in reform. We have to do everything in our power to address their concerns, but when you have labor representing almost 80 percent of the costs, they have got to be willing to do their share to provide for the future of the Postal Service.

That number, by the way, is astounding. I did go back to my own company because I believe I am a labor-intensive industry. I buy paper from your State and I use his presses, so I have a labor-intensive business. I only employ people, talented writers and reporters, but labor only represents 35 percent of my cost base. So that 75 to 80 percent cannot be ignored, and I think I saw a quote from Senator Durbin recently which I think says it all, and that was that we all should be willing to give a little to pass meaningful reform.

Chairman COLLINS. Mr. Angelson.

Mr. ANGELSON. Thank you, Madam Chairman. I would add that we are talking about predictions for adding 1.7 million addresses in the United States every year going out for 10 years, as far as we can see at this point. During that period of time, there will be natural attrition in the workforce of the U.S. Postal Service and we think that those are two statistics that, when worked together, will allow us to address this difficult issue in partnership, if you will, with our colleagues on the labor side so that we can get this done without inappropriately breaking anyone's rice bowl, if you will.

So we think, yes, it needs to be addressed, the labor issue, but we think it can be addressed in a way that suits the needs of all the constituencies.

Chairman COLLINS. You raise a very important point. Addressing the workforce issues does not mean laying off thousands of postal workers. In fact, 47 percent of the current workforce will be eligible for retirement within the next 10 years. So there is an opportunity to right-size the force without resorting to widespread layoffs.

But there are obviously many other issues involving workers' compensation, the collective bargaining system, where I think we can make some reforms that will be beneficial to the workforce as well as in holding rates down.

Senator Durbin.

Senator DURBIN. Thank you, Madam Chairman.

Illinois is a wonderful State and it is pretty flat. As you travel downstate, where my home is, cornfields and soybean fields in every direction as far as the eye can see. About 100 miles south of Chicago on Interstate 55, the old Route 66, there appears a mountain range. It startles you. You can't imagine, what is this all about? Well, it is because within a quarter mile of the interstate is a landfill and the landfill is huge, and I look at it every time I go by and it is growing. Maybe someday we will have a ski resort there, I don't know. It is not likely, but possible.

But it points to a real serious issue which I would like to address for a moment here because I can't think of two more important witnesses. Most of that bulk in that landfill is paper, and it strikes me as odd that in this conversation about looking to the future, which the reform of the Postal Service is all about, there is very little conversation about paper other than making certain that you do business in Maine, which is important to our Chairman. [Laughter.]

Senator DURBIN. A few years ago, I had a notion that perhaps we should encourage the use of more recycled fiber and perhaps even offer incentives in postal rates for those who would have a certain percentage of their product in recycled fiber and a concomitant penalty for those that didn't, creating an incentive that some of the catalogs and magazines that I receive would have at least some recycled fiber content.

I couldn't have ever anticipated the firestorm of opposition to that wildly radical idea. Everybody was against it, everybody, the unions, the Postal Service, those who print the magazines and those who write them. Everybody thought this was a completely irresponsible notion.

I am going to revisit that for a moment here, because I can't think of two better witnesses. Ms. Moore, of all the publications out of Time Inc., what would you say is the percentage of recycled fiber and paper that you use in your publications?

Ms. MOORE. I don't know the percentage. I know that we certainly have been very aware of the whole environmental issue. We have done wonderful work, actually, with our paper suppliers on the subject of chemicals and working hard to get recycled. I know that currently, 100 percent of our newsstand unsold copies are recycled and we are working right now on a recycle pilot project, I think in Boston, the City of Boston.

So it is something—I get this question at the annual meeting every year. It is something that we have been very aware of and that we are working hard on. But currently, we don't have a high percentage of recycled fiber in our current printing plants. I think a lot of the work done in the last couple years by the paper industry to lower the weight of our paper has done a lot of good in keeping that landfill down.

Senator DURBIN. Is it beyond the realm of possibility that some percentage of your publications would be recycled fiber? I understand that perhaps the covers and some of the features and the color pages and such, maybe recycled fiber isn't always appropriate. But is it beyond the realm of possibility to say that a certain percentage of your publication would be recycled fiber?

Ms. MOORE. To make that mandatory? At the moment, it is not economically viable.

Senator DURBIN. It is too expensive? Recycled fiber is too expensive?

Ms. MOORE. Yes, sir.

Senator DURBIN. Dramatically? I mean, is it marginal or——

Ms. MOORE. Dramatically.

Senator DURBIN [continuing]. Dramatically more expensive. Of course, you don't have to factor in the cost of the landfill nor the impact on what that means to a community which becomes a social cost which a lot of places around the world have decided is an important part of the equation.

Mr. Angelson, I know you are new to the job and I don't want to put you on the spot, but could you comment on that issue?

Mr. ANGELSON. I can speak personally and I can speak a little bit on behalf of RR Donnelley and would ask that we be allowed to respond more formally in due course.

Senator I agree with you that our children and our grandchildren and their grandchildren need to live on this planet and I applaud the spirit which moves you in the direction in which you are moving. We at RR Donnelley have long recycled the scrap paper that comes off the cutting, etc., as we prepare our products for our customers. To a very significant extent, though, our customers do the paper buying, if you will, and we do the printing on it. I would be grateful, in light of my 8 or 9 days on the job, if you will let me duck on this one.

Senator DURBIN. I want to revisit it, and I hope I can find some common ground with our Chairman. I know this is a delicate issue for her and it is an important industry in her State, but I know she is also sensitive to the environment that we live in and I thank her for her leadership and I thank you both for your testimony. Thanks, Madam Chairman.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. It is kind of ironic that my colleague, Senator Durbin, raised that issue, because last night when I brought my boys home from the Troop 67 Scout meeting, we did our recycling. We recycle twice a week. It is picked up at our curb in front of our house in Wilmington, Delaware, by a firm that we actually pay to pick it up because we don't have curbside recycling. I am proud to report I think we now may actually recycle more than we put out in our trash can once a week, which is no small achievement.

I certainly share his interest in recycling and that is not the reason for our hearing today. One of the things that I learned, I learned as a Governor when we were trying to reduce the amount of land that we had to set aside for landfills, one of the things that I learned is that in order to make recycling pay, we have to find folks who are willing to buy the recycled products.

I would just ask Mr. Angelson, you are new in your job. Ms. Moore, you are not so new. I would ask that you take to heart the comments that Senator Durbin made. Those are ones that I share, as well.

In terms of what in the magazines might lend itself to being recycled, maybe not the cover, maybe not the pages inside. But you

know those little inserts, like those little postcards you have to mail? Those really get in the way, and—— [Laughter.]

Ms. MOORE. Senator Carper, all insert cards are 100 percent recycled paper, you will be happy to know.

Senator CARPER. I should have guessed. I will feel more kindly toward those postcards in the future, armed with that knowledge.

Mr. Angelson, have you testified previously before a Congressional Committee?

Mr. ANGELSON. I have not, Senator.

Senator CARPER. What was it like?

Mr. ANGELSON. It feels just like home. I have three intelligent, I hope, and active and interested daughters and it feels like the dinner table, so——

Senator CARPER. That is good. I think you did a nice job, and Ms. Moore, you certainly did, as well. I knew you would.

Ms. Moore, would you go back and just share with us those three points? You closed your testimony with three points. I just want to revisit those for a moment, if we could.

Ms. MOORE. What are the three things that are kind of "must haves" in the reform bill? We would like you to resolve the escrow provision in military retirement. We would really like you to implement, Congress to implement, a CPI cap for rate increases. And finally, we really would like service standards for all mail classes. It is not enough just to have the low-cost provider. We need reliable service standards for all classes of mail.

Senator CARPER. We have had some discussion here amongst ourselves and with the Commission appointed by the President as to who might be responsible for establishing those service standards and what kind of reward or punishment might be meted out for failure of the ability to meet those service standards. Would either of you care to give us some advice on those points?

Ms. MOORE. Well, I think you want to implement—I think you want to follow best practices as you do in the business community. You want to first start with cost-based rates. Please make us pay for what we use. If I am inefficient in giving you a direct mail piece that can't be scanned, you should punish me with higher rates for that piece of mail. You can incent the users of the Post Office to help drive costs out. And I also think you want to do things like pay for performance. You should incent the management of the Postal System to be rewarded for running a low-cost, affordable service.

Mr. ANGELSON. I would agree with Ms. Moore, Senator. I would add that it is very important that in maintaining universal service, that Congress reserve to itself ultimately the right to regulate that monopoly for the benefit of all American citizens with the idea of having corporate governance in place for the Postal Service, which, as you know, if it were a Fortune 500 company, based on 2003 statistics, it would be number 11 in the Fortune 500. Governing it like a business, subject, of course, to reserving the right of Congress to maintain its most fundamental oversight, we think would be a very good thing.

Senator CARPER. With respect to governance, let us talk just a little bit about the makeup of the Board of Governors. As you know, there is no requirement in the law that they have to have

background experience consistent with the work that the Postal Service does. I think they serve fairly long terms, I want to say maybe 9-year terms. I believe for the most part they are selected by the President, nominated by the President, confirmed by the Senate.

The Commission has made some recommendations in this area. Several people would be appointed, nominated by the President, confirmed by the Senate. The rest would be independent Board members. There would be a requirement that these folks would have to generally have some experience that is consistent with the nature of the work of the Postal Service does. And rather than serving maybe 9-year terms, they would serve much shorter terms.

Now, each of you have experience with corporate boards of your own and I just ask you to reflect on your own experience. Think about what we are contemplating with regards to the structuring of the Postal Service Board and tell us how you think we ought to proceed.

Ms. MOORE. I was absolutely thrilled with the President's Commission and how you could attract two bipartisan chairs as experienced as Mr. Johnson and Mr. Pierce, and I wonder why you couldn't attract the same kind of experienced talent to the Postal Board, because here it has an enormous impact on the economy, on jobs, and I see no reason why you shouldn't recruit to the Postal Board this same thing we would do in manning a Fortune 500 board. I think there are a lot of able people with experience who would be willing to serve a limited term to get the job done in the future. That has not been done in the past, and I see no reason why you couldn't call on a lot of able people in the business community to fill some of those seats.

Mr. ANGELSON. Senator, I agree completely with Ms. Moore's remarks. In manning or womanning a private company board, we have had great success in choosing people—and again, these aren't the people who are going to actually be on the ground executing the decisions. These are people who follow the adage that when one has a symphony orchestra, one needs 100 people and there is somebody to play the triangle and somebody to play the drums and somebody to play the French horn, etc. We find that a broad cross-section of views from people with a broad and diverse cross-section of backgrounds most help in doing this.

It is a business, Senator, as you know, the Postal Service, and we think it ought to be run like a business, again, subject to preserving jobs where we can do so.

Senator CARPER. I realize my time has run out. Could I just ask one other quick one?

Chairman COLLINS. Certainly.

Senator CARPER. It relates to the line of questioning on the board. Do you recall what your board members are paid, just roughly, or your directors' fees? I presume that is public knowledge.

Ms. MOORE. I would say, typically—I think there is a broad range—I would say typically a board member of a Fortune 500 probably makes around $50,000 a year, often paid in stock, not in cash. That is a guess, but I think that is what I recall. I am on the nominating committee of a Fortune 500 company.

Mr. ANGELSON. I think that Ms. Moore's guess is very close to right. There is—in governance, and you might not have this advantage when you put together a governance body for the Postal Service, because paying them in stock is something that I am not sure would induce them to necessarily perform to their utmost. I would have said, if we were in an all-cash compensation system, that something around $50,000 would probably be right.

Ms. MOORE. But I would also add to that that I think you could probably, because of the importance of this, most sitting CEOs don't sit on the boards of companies any more for the compensation. It is a lot of hard work and it is vital to the health of our businesses. I think it would not be money that would attract us to the board, but helping the Postal Service stay strong.

Senator CARPER. Amen. Thank you. Thanks, Madam Chairman.

Chairman COLLINS. Thank you, Senator.

Ms. Moore, you indicated that one of your top three priorities is the establishment of an inflation-linked rate cap for the Postal Service. Under the Commission's recommendation for such a cap, the Postal Service would have the ability to set rates below that cap.

That leads me to ask you two questions. One, do you have any concern that the Postal Service would immediately jump to the cap, and second, should there be some sort of after-the-fact review of the rate structure to make sure that the Postal Service is not taking undue advantage of that latitude?

I understand the need to have more flexibility, more predictability, and to get away from the current adversarial process, which can take as long as 18 months. But there are also risks with just allowing the Postal Service to set its own rates without review. Could you comment further on that?

Ms. MOORE. Well, it is one of the reasons I would love Congress to set the inflationary cap guidelines. I could live with the Post Office having such a system and having the flexibility to raise rates up to that cap because it gives me predictability. I could budget for up to inflation every year or what the cap is.

I think that what you want to counter with is a pay for performance. Remember, we want to incent the management of the Post Office to run a low-cost efficient business. Not only does it take 18 months whenever the current system requires a rate hearing, but I have to tell you, I spend almost $1 million in providing reports every time there is a rate increase. The sheer waste of the current system is just intolerable.

So I think we would all be very happy to live with a rate cap system. I don't fear that the management would automatically go to the top cap if we incented them properly to run the Post Office as a business.

Chairman COLLINS. Thank you. Mr. Angelson, do you have anything you would like to add?

Mr. ANGELSON. I would support Ms. Moore's comments yet again. For us, it is about stability and predictability.

Chairman COLLINS. I want to thank you both very much for your testimony. We look forward to working with you.

Senator CARPER. Madam Chairman, could I ask just one last question?

Chairman COLLINS. Certainly.

Senator CARPER. Mr. Angelson, I think it was you who spoke about how difficult it is to get the Postal Service to enter into a work sharing agreement. Would you just go back and briefly revisit that for us and maybe tell us what you think causes that difficulty and whether you believe that we ought to be doing something legislatively to make it easier to do work sharing?

Mr. ANGELSON. Senator, it is about bureaucracy and it is about, if I may, concern about or fear of change. It is about entrenched ways of doing things. And yes, we would welcome any contribution that this Committee and ultimately the Congress of the United States could make to easing the way toward making the U.S. Postal Service a more business-like partner.

Senator CARPER. Thanks very much. My thanks to both of you.

Mr. ANGELSON. Thank you.

Ms. MOORE. Thank you.

Chairman COLLINS. Thank you. I want to thank both of our witnesses. Your testimony was extremely helpful and we look forward to working with you as we go forward and as Senator Carper and I draft our bill, so we would welcome any future advice that you might have for us. Thank you.

Ms. MOORE. Thank you.

Mr. ANGELSON. Thank you very much.

Chairman COLLINS. I would now like to call forth our second panel of witnesses. Chris Bradley is the President and Chief Executive Officer of Cuddledown, Inc., a manufacturer and catalog retailer of fine home furnishings based in Portland, Maine. Mr. Bradley also serves as the Vice President of the New England Mail Order Association of America.

Max Heath is the Vice President of Circulation, Postal and Acquisitions for Landmark Community Newspapers, Inc., of Shelbyville, Kentucky. Landmark Community Newspapers has 53 weekly and daily newspapers in 13 States and Mr. Heath is in his 18th year as Chair of the Postal Committee of the National Newspaper Association.

William Ihle is the Senior Vice President of Corporate Relations for the Bear Creek Corporation of Medford, Oregon. Bear Creek owns the well-known catalogers Harry & David and Jackson & Perkins. Mr. Ihle supervises all public relations, community relations, and government relations for the family of companies in this country and overseas.

And finally we are going to be pleased to hear from Shelley Dreifuss, who is the Director of the Postal Rate Commission's Office of Consumer Advocate. She was appointed to this position in April 2002 and has 25 years of litigation experience representing consumer issues in the Office of Consumer Advocate. I would note that her primary duties are the protection of consumer and small business interests in rate and classification cases before the Postal Rate Commission.

Mr. Bradley, we are going to start with you, not only because you are my constituent—— [Laughter.]

But also because you were the first person to educate me on the broader economic impact of the Postal Service. You organized a meeting of some 22 businesses in Maine, ranging from printers to

paper manufacturers to LL Bean and everything in between and it really was an eye-opener for me about the link between affordable, reliable postal rates and the jobs that we have in our State and nationwide. So thank you for that education and I am pleased to ask you to proceed with your testimony.

TESTIMONY OF CHRISTOPHER W. BRADLEY,[1] PRESIDENT AND CHIEF EXECUTIVE OFFICER, CUDDLEDOWN, INC.

Mr. BRADLEY. Thank you, Chairman Collins. Cuddledown is a small company located in Portland, Maine. We manufacture down comforters and pillows with most of our marketing done through a catalog we mail throughout the United States. We currently have 86 employees. Over the past 15 years, we have grown our sales from less than $1 million to more than $20 million. The engine for this growth has been our catalog and the U.S. Postal Service has been an essential partner in getting our message to our customers. I am here before you representing a small business that is dependent on a functional and affordable Postal Service.

Cuddledown prints and mails more than ten million catalogs each year. Our annual postage bill is roughly $3 million, but the impact of our business extends beyond that. We print our catalog in Mississippi and we use about 2,000 tons of paper each year, also manufactured in this country. The total value last year of our payroll, FICA tax, workers' compensation insurance, life insurance, long-term disability insurance, short-term disability insurance, health insurance contribution, and 401(k) contribution was $3 million. And like so many mail order companies, Cuddledown is located in a rural part of the country where good jobs are highly valued.

Mail order and the Internet allows small companies to spring up all over the country to grow, create jobs, be successful, and to realize the American dream. But the future of this dream now depends on the legislation this Committee crafts to reform the Postal Service. Without substantial reform, it is expected that we will once again see rate increases far in excess of inflation.

The last rate increase in June 2002 raised standard mail an average of 8 percent. For Cuddledown, that meant an increase in our postage bill of $240,000. That is eight good jobs at $30,000 per job that we would need to cut just to stay even. Given the weak economy and the job cuts that we have already seen, to cope with declining sales, large increases in postal rates will result in small business failures in my industry.

Reform is clearly needed and the President's Commission has outlined the reforms that need to be put in place. In reading the Commission's report and published comments from other involved parties, it seems clear to me that reform would include the following: Elimination of the escrow account for overpayments into the Federal Civil Service Retirement Fund; shifting the obligation to pay for military service retirement from the Postal Service to the Treasury Department; giving the Postal Service the ability to open and close processing plants and post offices to meet their business

[1] The prepared statement of Mr. Bradley appears in the Appendix on page 81.

demands; and enabling the Postal Service to use pricing and other services as tools to grow their business.

In my opinion, this last point will be the most important in the long run. You must give the Postal Service the flexibility it needs to compete in the current world. The biggest current threat to the Postal Service is the shift from physical to electronic mail delivery. First class and standard mail are under attack and mail volumes are projected to decline in future years. The Postal Service must grow the volume of mail, and the only way to do that is to be competitive in today's business world.

The current structure of the Postal Service represents the competitive forces of the era when man first set foot on the moon. The structure has been successful for 30 years, but the world has changed and the Postal Service must change to survive.

So what does it mean to be flexible and competitive in today's world? I can think of one example that dramatically illustrates how the Postal Service is stuck in another era and how they can change to increase their mail volume. Cuddledown buys goods and services from hundreds of suppliers, yet the only supplier that does not extend us open credit terms is the U.S. Postal Service.

Trade credit is the lubrication that keeps the business world running and growing. The Postal Service needs to compete in the modern business world, and yet their terms are cash in advance as if their customer had no other choice. This policy is straight out of the 1960's, at a time when EZ–PASS was science fiction and trying to use your BankAmericard at the grocery store would have been met with polite refusals, at best.

Cuddledown mails catalogs 18 times each year. The postage is removed electronically from our corporate checking account on Friday. The catalogs begin to move on Monday and begin arriving in our customers' homes the following Monday. Our average catalog is delivered 12 days after payment has been made. The only competitive part of this process is the electronic debit to our bank account, and that is ironic because it saves us the postage cost of mailing our check. [Laughter.]

UPS, FedEx, and Parcel Direct all give us open terms. Our printer, color separator, photographers, and models all give us trade credit. When we buy down or fabric to make our down comforters, we have standard payment terms. When we sell our comforters, pillows, and sheets to other retail stores, we extend them standard credit terms. I can even think of a guy from China who sells us down-filled booties. We meet with him in Germany. He has never been to Maine, much less visited us at our factory, and yet he is willing to give us trade credit. Trade credit is reasonable, it is controllable, and it is expected in today's world, yet the Postal Service still requires their customers to pay in advance.

So why should you give the Postal Service the ability to extend normal trade credit? Because they could use it to grow their volume. Paying in advance and waiting 12 days for your first results is a roadblock for any business and especially a small business. Cash flow is critical for a business, and many decisions, especially the question of how many pieces to mail, revolve around the impact on cash flow. If commercial mailers could match the timing of their

postage payments with the delivery of their mail, they could mail more volume and they would.

Would trade credit result in significant bad debt expense for the Postal Service? I don't think so. The last supplier that a mailer would fail to pay would be the Postal Service because they would cut off its source of cash. It would be like failing to pay your phone bill. It is just not done by a mail order company.

The Postal Service could easily control their expense and the marginal cost of mail delivery is low, so the risk of bad debt is low. The risk is low, the reward is great, and the very survival of the Postal Service depends on new ideas that will reverse its declining mail volume.

Extending trade credit is just one idea that will help the Postal Service compete and thrive in today's world. There are probably many others out there, and the important thing is that new legislation is passed that will enable the Postal Service to take advantage of the opportunities that are available to it. The business climate in the United States requires constant creativity and innovation just to survive. The legislation that formed the Postal Service in 1960 served it well for many years, but now that same structure is a threat to its very survival. Electronic communication has irreversibly changed the postal world and it is up to Congress to create new structure that will allow the Postal Service to serve its mission for the next 30 years.

Thank you. I appreciate being invited today and having the time to talk.

Chairman COLLINS. Thank you. Mr. Heath.

TESTIMONY OF MAX HEATH,[1] VICE PRESIDENT, LANDMARK COMMUNITY NEWSPAPERS, INC., ON BEHALF OF THE NATIONAL NEWSPAPER ASSOCIATION

Mr. HEATH. Thank you, Madam Chairman and Members of the Committee. My name is Max Heath. If I may, I will speak briefly today and submit a longer statement for your record.

Chairman COLLINS. Without objection.

Mr. HEATH. I am Chairman of the National Newspaper Association's Postal Committee and I am a Vice President of Landmark Community Newspapers, Inc., a private company operated out of Shelbyville, Kentucky. As the Chairman said, we own 53 small newspapers, 34 related shoppers, about 25 related specialty publications, and 19 printing plants which both print on newsprint and mail publications for other people, including our own newspapers, and these are all across the country. I also serve as one of two NNA representatives on the Mailers Technical Advisory Committee formed by the Postmaster General about 35 years ago now, I believe, and have been on that since 1989.

NNA supports postal reform and has worked for the past decade to help craft legislation that will provide the Postal Service with new tools to remain viable in this century while protecting the interest of small newspapers. NNA has about 2,500 member newspapers in America. I bring greetings from many of the publishers

[1] The prepared statement of Mr. Heath with an attachment appears in the Appendix on page 85.

in your State, including, Madam Chairman, the publisher of the *Ellsworth American,* Alan Baker, who you know well, who is a member of NNA's Board of Directors and who is a firm supporter of NNA's excellent relationship with the Postal Service. Also in Senator Carper's State we have Tom Bradley, the President of the *Chesapeake Newspaper* that operates in Maryland and Delaware, former NNA President.

I would also like to insert here a point about the recycled content on the record, since that was brought up earlier, if I may. Newspapers are about 60 percent users of recycled newsprint and all the mills that we operate now include post-consumer content in that fiber that we buy. One thing we have learned as the States have tried to put in local laws to govern the use of this is that you can't recycle forever. You always have to have some new fiber coming in because the fiber does wear out, so there is not such a thing as 100 percent newsprint recycled.

The typical member of NNA is a family-owned weekly of about 3,000 to 7,000 circulation. Almost all of these depend upon periodical mail for their primary circulation and often use standard mail to deliver advertising to non-subscribers To illustrate, my company in 2003 spent $3 million in standard mail postage, $2 million in periodical postage, and only four-tenths of a million in first class postage for our total of $5.4 million postage bill.

The membership of NNA also includes a number of small dailies, most of which are under 10,000 circulation and many of which are heavy mail users. In fact, we even have small dailies that continue to depend upon the Postal Service for the primary delivery of each daily issue. I have consulted with some of those States, such as Michigan and other places.

I have provided postal consulting services through my NNA hat and in my Landmark position for nearly 20 years now and have also visited and seen newspapers in other countries. What is remarkable to me is the wide diversity and importance of the community press in America, compared to some other countries where there are one or two major national newspapers and possibly some smaller dailies.

I think the critical element in this country for the hometown newspaper has been the Postal Service. Because of it, just about every county seat has its own newspaper and some of them have two or more even. Our Nation depends upon those papers to deliver information on local government and politics, including many of your local newspaper columns, and community activities. Even in an Internet age, we think there is no viable substitute for these newspapers. Community newspapers are continuing to grow in this country in total circulation even as metro papers, large State papers are on somewhat of a decline in the last 10 or 15 years.

Congress ensured that we would have a thriving community press in the 19th Century when it developed postal rates that were designed precisely to give the new frontier its own local newspapers. The large New York dailies were mailing heavily into the developing South and West and Congress sought to provide that a local publisher could successfully compete by providing favorable rates.

Because those favorable rates had to ratchet up to cover the full direct and indirect cost of delivery in 1970, our publishers have experienced dramatic rate shock. Even with the largest of work sharing discounts available now, our within-county rates have gone up more than 850 percent since postal reorganization, and at the basic level rate, there is a more than 2,000 percent increase.

In 1993, Congress put a ceiling on the contribution of our postage to the Postal Service's overhead cost, pegging it to the outside county periodicals rate. In the past few years, we have exceeded the ceiling. For example, in the 2002 Postal Service cost and revenue reports, we contributed 102.2 percent of our cost while outside county mail contributed 90.6 percent. The report demonstrates that our mail is not inefficient or unprofitable to the Postal Service. It does show a small profit. But it does require some extra work on our part and on the part of you and the Postal Service to ensure that we remain viable. Because our costs are so small and our mail is such a small part of the domestic mail stream, we sometimes become lost in the shuffle.

So that brings me to my first request of the Committee. As your work continues, we hope you will make sure that our newspaper mail remains a distinct class within the mail stream and is not swallowed up by larger, more costly mail class.

My second request addresses the Postal Service's need for more flexibility in managing its business. We agree with the need to provide the Postmaster General more management control. This includes more flexibility in dealing with labor and capturing automation savings.

We have a concern with the recent trend toward negotiated service agreements, however. While we do not oppose them outright, we think they should be based upon work sharing partnerships, and if they are, we think niche classifications are a far preferred tool, something that can be enjoyed by a wider class of mailers and not just one large company.

We have consistently stated through postal reform discussions that NSAs that are crafted primarily upon volume-based incentives are unwise and are unfair in particular to small mailers. Even though NSAs may be extended to other mailers that are similarly situated, a small mailer may find a massive NSA competitor in his market and be unable to qualify for precisely the same sort of NSA.

Therefore, we have urged the Postal Service and the Postal Rate Commission to require these NSAs to be sufficiently specific in their details and sufficiently open ended that a small mailer could request to perform the portions of the larger NSA that it is able to do and to earn proportionately similar discounts. We will make the same request of this Committee as it drafts legislation. We believe that if you leave this portion out of postal reform, the eventual NSAs may force small volume mailers out of the mail stream or even out of business, and the Postal Service will be the net loser due to the law of unintended consequences.

There are a number of recommendations of the President's Commission with which we heartily agree. We certainly agree that continued reform of the Postal Service's Civil Service Retirement System contributions is needed. We supported passage of P.L. 108–18. We appreciate your work on that. We were dismayed by the addi-

tion of a burden for military pensions, like you have heard from many others. We can find no justification for this burden. No other government agency bears it and no private corporation, of course, has to contribute to military pensions.

Although the Postal Service is a hybrid of government and private, one would certainly assume that its obligations in this area would be similar to one of those two, and in this case, it is like neither one. We strongly urge that the escrow of payments in 2006 be ended and a plan worked out for using the savings of lower CSRS payments.

We are also agreed that the Postal Service should be permitted to right-size its network. It may be surprising to some to hear me, the champion of small rural newspapers, agree that closing some postal facilities may be necessary. Yet I think it is time to give the Postmaster General the ability to decide how many facilities he needs. There are some situations where very small post offices and even processing plants will still be needed for universal service. I think he understands that and that his strategic changes will be sensitive to the many needs of communities.

No one likes to lose jobs or facilities in their areas, and certainly not newspapers. But I think we all recognize that some change is going to be needed to keep the Postal Service viable, and I am willing to give the Postmaster General a chance to make some adjustments. If service standards are established and observed, I think he has the right to figure out how to achieve them. If he guesses wrong, Congress always has the ability to step in, and we will certainly be there letting him know at the quarterly meetings.

In the end, Madam Chairman, I think we all are going to have to make some adjustments to keep the Postal Service viable. We appreciate the work that you and your Committee are doing and we look forward to assisting you as you develop this legislation to provide America with a sound Postal Service in the 21st Century.

Chairman COLLINS. Thank you, Mr. Heath. Mr. Ihle.

TESTIMONY OF WILLIAM J. IHLE,[1] SENIOR VICE PRESIDENT, CORPORATE RELATIONS, BEAR CREEK CORPORATION

Mr. IHLE. Thank you, Chairman Collins and Members of the Committee for providing the leadership that we so desperately need to reform the U.S. Postal Service. I am Bill Ihle and a Senior Vice President of Corporate Relations. I am here today on behalf of our companies owned by Bear Creek Corporation, Harry & David and Jackson & Perkins.

Bear Creek is an active supporter of the Postal Service. Our CEO is an active member of the Direct Marketing Association and appreciated the invitation to be here today. However, she is planning Christmas already for Harry & David and was unable to make it, so I am here in her stead. Our Senior Vice President and General Manager of Customer Operations is Vice President of the Parcel Shippers Association and we are active in other industry associations.

Harry & David is recognized as America's largest shipper of gourmet foods, fruits, fine chocolates, and baked goods. Hopefully

[1] The prepared statement of Mr. Ihle appears in the Appendix on page 97.

you have enjoyed our Fruit of the Month Club. Maybe a Royal Riviera pear or the always wonderful "Moose Munch." At this time of year, it is particularly popular.

Jackson & Perkins is the Nation's largest garden and rose company outside of Bakersfield, California. We grow 9.8 million roses, and I might say also, 3 years ago, Harry & David and Jackson & Perkins received the U.S. Conference of Mayors awards for small companies for their recycling efforts, something we are quite proud of.

We employ more than 2,000 people year-round and 8,000 additional employees in cities such as Medford, Oregon, and in Newark, Ohio. We have call centers there. We have our distribution centers there. We have warehouses, and we have our executive offices.

We use all classes of mail to communicate with our customers, but our success ultimately depends on accurate, on-time, affordable package delivery, and the U.S. Postal Service is our primary resource for this task. Frankly, our companies would likely perish without affordable U.S. Postal Service that offers universal service and stands ready to deliver our packages to every city, every village, every hamlet, and yes, that includes Caribou, Maine.

We agree with the President's Commission that the service models will not work in the future and we agree with many of its recommendations. We are pleased that the bills your Committee and the House Committee has considered before, S. 1285 and H.R. 4970, are consistent with those recommendations and we believe that they would largely get the job done. We must emphasize how important it is that both bills confirm the mission of the Postal Service, the physical delivery of letters, printed matter, and packages, and we hope a lot of Harry & David packages along the way. We believe that both bills will also support the principles the administration says should govern reform, best government practices, transparencies, flexibility, accountability, and self-financing.

Consistent with those principles, we think that there are more specific criteria that reform should guarantee—continuance of universal service; greater flexibility in the Postal Service's ability to fix prices and services; the deregulation of competitive products, such as parcel post, Priority Mail, Express Mail, so that the market will govern the prices and services; right-sizing the Postal Service infrastructure, redefining the regulatory regime to ensure that the Postal Service is performing its mission and that it ensures transparent operation, financial controls, and the fair and equitable rate structure; adequate compensation for postal employees at all levels in order to attract top-level employees and to give them the proper incentives; and end escrow of the CSRS savings and correct the military service credit situation.

I would like to address two of these principles more specifically, the core service and increased competition for package delivery.

We agree with the President's Commission that the Postal Service continue as a public service with a universal service obligation that package delivery should continue to be the core function of the U.S. Postal Service. For more than a century, package delivery has been an essential and integral part of what the Postal Service does. The fact that private sector companies have been successful in the parcel delivery business in no way alters the necessity of keeping

the Postal Service in that business to ensure that there will be competition.

We could not support any reform that would cut the Postal Service from the package delivery business because we believe that would end the universal service that our companies have come to depend upon. I repeat, of particular importance to us is 6-day affordable, universal, reliable package delivery service. There is no reason given the existence of competition for package delivery service to require the Postal Service to seek advance approval from regulators of its rates and practices as long as those rates and practices do not amount to unfair competition and cross-subsidy. Without the Postal Service, there simply would not be competition.

Moreover, the Postal Service provides a unique service. Only the U.S. Postal Service provides truly universal parcel delivery service—post office boxes, A.P.O., F.P.O., Alaska, and Saturday delivery to just name a few examples. It does not impose a surcharge on residential delivery and does not compel the ordinary citizen to pay hefty charges or go to a franchisee in order to send a single package. In fact, the Postal Service's competitors hand packages over to the Postal Service for delivery that they find inconvenient, difficult, or too costly. The USPS does not do that. It is the carrier of last resort. It goes the final mile virtually every time.

Naturally, we want as many competitors for our delivery service as possible. At the same time, we understand the need for a level playing field. It is not in our long-term interest for any of the vendors who provide our transportation service to have an unfair advantage over others because that will soon end in a recentralization and monopolization of that service. We are pleased that S. 1285 and H.R. 4970 protect against cross-subsidization and competitive products and strike the right balance.

The Postal Service is living on borrowed time. Were it not for the efficiencies the current Postmaster General and his dedicated staff have been able to achieve and the one-time savings from the temporary fix of the CSRS, the Postal Service would already be in crisis. A few nay-sayers should not be allowed to stand in the way of the perseverance of this indisputable public service, a universal Postal Service.

I thank you for your consideration and would welcome further questions on how our companies are so dependent upon the Postal Service and our further thoughts on how to reform the future of the postal companies.

Chairman COLLINS. Thank you. Ms. Dreifuss.

TESTIMONY OF SHELLEY DREIFUSS,[1] DIRECTOR, OFFICE OF THE CONSUMER ADVOCATE, POSTAL RATE COMMISSION

Ms. DREIFUSS. Chairman Collins, thank you very much for allowing me to testify today on behalf of consumers and small businesses. It is an honor and privilege to share my views with you today.

Postal legislation of 1970 explicitly provided for a representative to protect the interests of consumers and small businesses when postal rates were to be changed and new classes and services es-

[1] The prepared statement of Ms. Dreifuss appears in the Appendix on page 107.

tablished. This continues to be a vital need today. I ask that you and your Committee explicitly provide for a Consumer Advocate in postal reform legislation that is presently under consideration.

Mail to and from consumers and small businesses comprises the vast majority of the postal mail stream, approximately 80 percent of postal volume. Yet the individual usage of mail is relatively small on a per household basis. Individual mailers spend an average of $7 per month on postage. This amount is too small a percentage of a typical household budget to spur individual mailers to intervene in postal rate and classification proceedings. This holds true for small businesses, as well, those that spend a fairly small percentage of their budgets on postage.

Without an independent Consumer Advocate to litigate on behalf of small volume mailers, the needs and concerns of small volume mailers will rarely come to the attention of a postal regulator.

Large businesses, particularly those that regularly spend a sizeable percentage of their budgets on postage, find it in their economic interest to intervene on an individual company basis or as part of an association. They direct their energies and resources toward developing an evidentiary record that shows the effect of rate increases on their businesses. Without a consumer/small business advocate, the evidentiary record is unbalanced and incomplete. Evidence of the impact of rate increases on consumers and small businesses must also be brought to the attention of the postal regulator through the intercession of a Consumer Advocate.

My office has represented consumer and small business interests for 34 years and has achieved a long string of victories on their behalf. I would like these protections and successes to be carried forward in the new era of postal legislative reform.

The two main objectives of consumers and small business mailers are the same today as they were 34 years ago. They need high quality, reliable services at low prices. I must caution that the mechanisms that are intended to produce downward pressure on costs may have a corresponding tendency to produce downward pressure on service quality. For that reason, I endorse new mechanisms that will establish and maintain high levels of service performance at the same time costs are being controlled.

A high level of postal services can be established by giving the Postal Regulatory Board the duty and power to establish service standards for every postal product and service. The consumer representative should be explicitly designated by statute to intervene in such proceedings.

High quality postal services will be maintained by giving the Postal Regulatory Board the power to order the collection and reporting of detailed information on how well the Postal Service is meeting the service standards established by the Board. The Consumer Advocate should be given the power to file complaints when service falls below minimum standards.

To protect consumers and small businesses from a disproportionate share of increases in postage, I ask this distinguished group to explicitly provide for a consumer representative in the baseline postage rate increase case that is planned to launch the new system of price controls. I also ask that the consumer representative be designated to participate in future postal rate and classification

proceedings so that no changes can be made without specific consideration of consumer impact.

Consumers and small businesses will be one of the major sources of funding for universal service. I do not think it advisable to shrink over time the base of mailers who fund universal service. I am concerned about a recommendation that would produce this situation by shrinking the postal monopoly. As the captive customer base shrinks, there will be fewer and fewer mailers contributing to the expenses of universal service and the fixed costs of the Postal Service. The prices that they pay will necessarily grow larger and larger over time because their share of fixed costs will grow larger. It is a mathematical law that cannot be escaped. Therefore, I recommend against a narrowing of the monopoly in proposed legislation.

Again, many thanks for the great privilege of allowing me to testify this morning and I would be very happy to answer any questions you may have.

Chairman COLLINS. Thank you for your testimony.

Mr. Bradley, you mentioned in your testimony that the 8 percent rate increase that occurred in June 2002 meant for your company an increase in your postal bill of $240,000 and you equated that to being equal to eight good-paying jobs in Maine. Is there a particular problem for catalog companies when postal rates go up unexpectedly in view of your inability to adjust costs? In other words, I assume a catalog company sets the prices in advance. You are printing catalogs way in advance, and if you have to endure a postal rate increase in the interim, you can't adjust your prices to recover those costs. Is that part of the problem?

Mr. BRADLEY. That is certainly part of the problem. The inability to adjust quickly is always inherent in the catalog industry because right now, we are working on the holidays and we are actually working on probably 2005 right now. We don't set our prices that far in advance, but we are very inflexible once we get close to a date. So it is very difficult to adjust.

Also, we are not charging for the catalog. It is sent out free as a form of advertising. So we have to raise the prices of our products if we are going to cope with an increase in postage, and we are in competition with every other form of commerce in the United States. So for us to just increase prices because we have an increase of cost doesn't really work.

I mentioned eight jobs just to give a benchmark of what that would mean. You are really looking at cutting costs too, all things being equal, so you try to raise a little bit, cut a little bit, and try to survive. In an environment like we had, when we had three postage increases in less than 2 years, I think more like 18 months, that was a very difficult time because your costs are going up and there is just really no way to pass that on effectively and efficiently and competitively to your customers.

Chairman COLLINS. So if anything, the current system forces you to look at reducing jobs because if you are coping with three price increases from the Postal Service in an 18-month period, you cannot recoup those costs through adjustments in your product prices, both because catalogs may already be printed, but also because you are in a competitive market, is that correct?

Mr. BRADLEY. Right. You can't raise the price of your products just because one of your costs has gone up unless that applies to everybody out in the retail world. Catalog and Internet, home shopping all combined, they are probably only about 15 percent of sales for our product categories in the United States. So you have got 85 percent of the sales occurring in retail stores and that is where your competition is. You have to pay attention to the competitive environment for pricing your product.

Chairman COLLINS. Mr. Heath, many mailers have criticized the current 18-month rate setting process as being too adversarial, too expensive, too time consuming. We heard Ms. Moore from *Time* magazine say that she spends $1 million in intervening in the average rate proceeding.

Consequently, the Commission and many other experts have recommended streamlining that whole process. Are you concerned that that would limit your ability as a stakeholder, as someone who is very affected by the outcome of the rate proceedings, if we move to the kind of system recommended by the Commission? Is there a trade-off for you that is worth it?

Mr. HEATH. I don't think we object to that because we don't have $1 million to spend, so we don't spend it, but $100,000 or so for our association to defend the situation. It is so drawn out and there are so many economic discovery issues that have to come up that if there could be ways to implement a shorter process and look at rate bands that are held below the cost of inflation, I think we supported some of those concepts and still will. So I think an abbreviated process is certainly in the interest of everybody in the mailing community and we don't have any objection to that.

Chairman COLLINS. Mr. Ihle, do you agree with that?

Mr. IHLE. Yes. When we went through the postal increase, it cost us $8 million last year, not last year but the year before last when it went through. That had to come from somewhere. The catalogs are already preprinted. Our big expense is, it is not so much shipping out the catalogs, it is the parcels. If you already have your rate structure set in the catalog and the pricing, then all of a sudden in the middle of the year you get $8 million, that can be the difference between a good year and not a good year.

It is a horrible shock to come in the middle of the year. You think you are on track. You think the year is going to be good. Consumers are responding. And then all of a sudden you get a bill for $8 million. That is a tough run.

Chairman COLLINS. Ms. Dreifuss, the current rate setting process is adversarial in nature. It is very expensive and it takes too long. But you raised an interesting point this morning and that is that your office is able to intervene in the process to make sure that voices that might not otherwise be heard—small businesses, individual consumers—are represented. If we give the Postal Service the authority to set its own rates within a cap, how would we ensure that the important voices of consumers and small companies are heard in the process?

Ms. DREIFUSS. One very important measure you could take would be to make sure that there is consumer representation in that baseline case that starts the price cap system. In that way, we would make sure in the baseline case that all first class rates, Pri-

ority Mail, Express Mail, special services, that they are set in the proper relation to everyone else's rates.

Now, in the future, I think it is possible—no one would like to see this happen, but it may be possible even under a system of price caps that the Postal Service will sometimes even be unable to live within the price cap. I don't know if legislation will provide for still further increases, but certainly if there were to be such increases, I would very much like to have a consumer representative there to make sure that a disproportionate share isn't shifted onto the backs of the captive customer.

Chairman COLLINS. So you see that baseline case that is going to be used to establish the cap as a way to ensure the involvement of your office on behalf of small businesses and individual consumers?

Ms. DREIFUSS. Indeed, and I would hope to the extent that there will be future rate, classification, and service proceedings, even under our new regime of postal activity, that there would also be a consumer representative in those proceedings, as well.

Chairman COLLINS. Mr. Bradley, the General Accounting Office has criticized the Postal Service in many reports for not having transparency and accountability in its financial statements, that it is very difficult to figure out exactly what is going on, whether cross-subsidization is occurring, whether or not the Postal Service costs are fully accounted for. If we are going to give the Postal Service more authority to set its own rates, does that need to be accompanied by new requirements to ensure that there is transparency in the financial reporting of the Postal Service?

Mr. BRADLEY. I am not a student of the Postal Service and certainly the accounting of the Postal Service, but it would seem that it would be essential that you would have transparency in looking at the financial performance and being able to segregate different classes of mail and evaluating the specific costs of those classes of mail and being able to attach rates based on that. I think it seems essential.

Chairman COLLINS. Mr. Heath, do you have any comment on that?

Mr. HEATH. Well, we, too, like other associations and mailers, at times have had difficulty getting what we consider to be accurate information or sometimes information at all regarding the particular issues that we are trying to work with in a rate case. We cite in our testimony a problem that happened in the 1994 rate case where they came out with a 35 percent increase in in-county rates and when they got through refiguring their numbers, it was actually a negative 1.5 percent, so quite a big difference there.

So especially with measurement of in-county volume and in-county costs, being the small class it is, we have a lot of concern about some of those issues and certainly we support any efforts that could be made to have better data and have that better data more shared and more shared on a regular basis between rate cases, not just in discovery and having to beg and borrow and subpoena. But if subpoena power needs to be there, we support that.

Chairman COLLINS. Mr. Ihle.

Mr. IHLE. Transparency is essential, Senator.

Chairman COLLINS. Ms. Dreifuss.

Ms. DREIFUSS. Chairman Collins, I think in order to make a greatly reduced rate case, a streamlined rate case work, it is absolutely essential that the Postal Regulatory Board have the power to require the Postal Service to collect and report the data that would be necessary to move forward quickly in the case. In that way, the public will be well informed about the Postal Service's costs, revenues, and volumes before the case ever begins.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. Thanks very much.

Ms. Dreifuss, I had to be in and out during your testimony. Could you just take maybe one minute and just summarize very briefly the heart of the thoughts that you would want me to take out of here that you have conveyed?

Ms. DREIFUSS. I am delighted, Senator, to do that. What I said was that consumers and small businesses spend a very small percentage of their budgets, of their household or business budgets, on postage. Very large businesses and in particular those large businesses whose budgets have a very sizeable percentage of postage as being one of their expense items—Time Inc., for example—I want to make a contrast here that large businesses or businesses that have a sizeable percentage of their budgets on postage do intervene in proceedings. It is in their economic interest to do so. However, by contrast, consumers and small businesses, with their small involvement in postage, don't.

And that is why I think we need to have a Consumer Advocate. We have had one since 1970 and I would like to continue to see a Consumer Advocate in the future.

Some of the other points were actually made in response to Chairman Collins' question just now, and that, I think, covers it pretty well.

Senator CARPER. Good. Thanks very much.

Mr. Bradley, I think early in your comments you mentioned that the U.S. Postal Service was barred from extending trade credit to its customers. Did I hear you correctly? They are barred?

Mr. BRADLEY. I am not aware of that policy being extended. The point that I was making is that out of all the vendors, hundreds of vendors that we deal with, and we are a fairly small company, they are the only one that has no ability or inclination to extend us simple payment terms, such as UPS, FedEx, Parcel Direct would do. They do the service and we pay really in conjunction with it being completed.

Senator CARPER. I would ask any of the other panelists or witnesses, are you aware of a legislative constraint that keeps the Postal Service from negotiating trade credit? No? Let the record show that a shaking of heads no, indicated no.

Mr. Heath, where are you from?

Mr. HEATH. Kentucky.

Senator CARPER. Whereabouts?

Mr. HEATH. Shelbyville, just due east of Louisville. I am formerly from Campbellsville down south.

Senator CARPER. Do you know my mother? [Laughter.]

Mr. HEATH. Well, I could. Where is she from?

Senator CARPER. Actually, she lives right across the line from Huntington in a little town called Ashland. My sister is in a place just to the east of Lexington, a place called Winchester.

Mr. HEATH. Winchester, right, a beautiful little town.

Senator CARPER. Keep an eye on them for me, if you would.

Mr. HEATH. We will. [Laughter.]

Senator CARPER. I want to go back to something that you talked about, Mr. Heath. A couple of our witnesses have come before us and talked about negotiating service agreements. I believe you cautioned us about large volume customers being able to negotiate those kinds of agreements, but smaller volume customers not being able to.

In the legislation that I introduced last year, I think it allows small mailers—relatively small mailers—whose business is largely local to apply for negotiated service agreements. We tried to make sure in that legislation that a small newspaper, whether it is in Dover or Ashland or some other place, could get a negotiated service agreement with the U.S. Postal Service if a large mailer that they were competing with in Dover or Ashland were able to get one. Would that be something we ought to try to include in our final bill?

Mr. HEATH. We are very sold on the concept of work sharing and our association was involved in some of the very early work sharing rates that went on in the early 1980's so that if you presort your mail to certain levels and if you walk sequence it to certain levels, you get better rates, if you enter it at the office of delivery, like many of our publications do, both for newspapers and advertising mail.

So we don't quite understand why there can't be more niche classifications that broaden the concept of work sharing to more mailers. That is what we basically advocate and we sort of stick with that. I suppose that if there is a way that this similarly situated language that has been kicked around could actually work—we haven't seen it work just yet. We sort of believe in the concept, but we are not sure exactly how that is going to end up working in the final analysis.

We just believe that if we do the same amount of work to get a piece of mail to an additional location than some competitor, or the same location as some competitor in some places, that we should have basically the same rates for it. We send out a lot of ad mail just like, for instance, Adville Systems does that serves our preprint customers going right down to the carrier route and we don't necessarily think, or, in fact, we don't think that just because they happen to enter so many billion pieces a year and we may enter a few hundred thousand, if we are doing the exact same level of work entered at that delivery office that we should have any less rate than they do. So that is why we feel the parity issue is very important.

Senator CARPER. All right. Good. Thanks.

I would like just to talk a little bit or ask you to talk a little bit about universal service, and I ask you to keep your responses brief so everybody can have a shot at this. What do you believe universal service to be? Do you think it is fully defined in current law or ade-

quately defined in current law? How do you envision universal service changing in coming years?

So it is a three-part question. What do you believe universal service to be? Is it adequately defined in current law? How do you see it changing in coming years? I don't care who goes first. We could do it in alphabetical order, though. [Laughter.]

Mr. IHLE. I will take it first. We believe that universal service has to include package delivery. It has to be able to go to not only big towns but small communities. It has to include Saturday delivery. As we saw this year, I believe Christmas Eve was on a Saturday this year. Being a cataloger, and I suspect you feel the same way, that cutoff period where you have to cut off the phone orders and the Internet orders, for us it was, I think, December 19. That window in between the 19th and the 25th, the 24th for Christmas Eve, is a huge delta for us. If we can have that Saturday delivery and it happens to fall in that period of time, that is a huge incentive for us. It has to include packages and it must include Saturday.

Senator CARPER. Thank you. Others, please?

Mr. HEATH. We, too, in the newspaper business still feel that 6-day delivery is important. Many of our members use Saturday for delivery of newspaper issues and shopping advertisement material.

To us, universal delivery sort of increasingly seems to mean access to the full range of products and services that the Postal Service has. We are concerned, for instance, that the Postal Service had difficulty dealing with automation of our newspapers and we wanted to play, and we worked with a lot of work groups to play in that arena and make sure we are participating, and yet the machines too often are built maybe not to include the widest possible range of materials that need to go through them. So we can be part of this cost savings that needs to go on in automation.

So to us, universal service means to not leave outside the best and most efficient part of the mail stream products that are very essential to local subscribers and to people all across the country, snowbirds and so forth. Many of our products go South for the winter and we have a lot of difficulty with that.

So we are trying to view it a little bit as how accessible the whole system is and how much we want to be a part of the best, most efficient part of that mail stream. That is kind of an important issue for us.

Senator CARPER. Thank you, sir. Ms. Dreifuss.

Ms. DREIFUSS. I would be happy to go next. I think universal service means giving the public access to a Postal Service, a Governmental Postal Service, that will accept letters, packages, periodicals, and make delivery of those items to every home and business in the United States. I think it includes 6-day delivery.

One point I want to stress that is often overlooked, everyone seems to accept that—and businesses in particular would like to have delivery made to every home and business in the United States. But I don't want anyone to forget that in States like Maine, and I am sure many parts of Delaware, it is necessary for consumers and small business people to have ready retail access to these services. So I do think that should be part of the definition.

Senator CARPER. OK. Thank you.

Mr. Bradley, the last word.

Mr. BRADLEY. Universal service, I think to me is similar to what Ms. Dreifuss said, access throughout the whole country. I see the Postal Service as being responsible for what is termed as the last mile, being able to go to every home and business in the country.

I personally am not sold on 6-day delivery. I may buck the trend. I don't know what the Postal Service would——

Senator CARPER. Do you want seven? [Laughter.]

Mr. BRADLEY. No, I was thinking five, but I am not sure what they would do with the mail on that other day. Logistically, I don't see how you could avoid Saturday delivery. I think the mail would logistically have to move on that day.

But I think that the Postal Service is in that unique position and has that unique responsibility of going that last mile and is responsible for that and work sharing with others, such as FedEx going and being dropped off to the Postal Service to be delivered that last mile, those are all very appropriate.

Senator CARPER. Good. Those are helpful responses and we appreciate each of them and we appreciate your being here. Thank you for contributing to our deliberations and we look forward to taking your thoughts into consideration when we try to mark this bill up. Thanks so much. Thank you, Madam Chairman.

Chairman COLLINS. Thank you, Senator Carper.

I want to end this morning by emphasizing a point that Mr. Ihle made, and that is that it is only the Postal Service that provides 6-day-a-week delivery of mail to every address at a uniform rate, what Mr. Bradley referred to as delivery to that last mile. I think as we craft a postal reform bill, we need to remember that.

At our next hearing on Thursday, we will hear from two of the Postal Service's competitors, Federal Express and UPS, and I look forward to hearing their views on this issue, as well.

I very much appreciate the testimony of all of our witnesses today. Your insights have been very valuable to us. You represent a real range of entities affected by the Postal Service. We are going to continue to work on this issue and we would welcome your advice and input as Senator Carper and I sit down at the end of these hearings to draft a bill.

The hearing record will remain open for 15 days for the submission of any additional materials that our witnesses or others may have.

This hearing is now adjourned.

[Whereupon, at 11:54 a.m., the Committee was adjourned.]

POSTAL REFORM: SUSTAINING THE 9 MILLION JOBS IN THE $900 BILLION MAILING INDUSTRY

THURSDAY, MARCH 11, 2004

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

The Committee met, pursuant to notice, at 9:30 a.m., in room SD–342, Dirksen Senate Office Building, Hon. Susan M. Collins, Chairman of the Committee, presiding.

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

OPENING STATEMENT OF CHAIRMAN COLLINS

Chairman COLLINS. The Committee will come to order.

Good morning. Today marks the sixth in a series of hearings the Governmental Affairs Committee is holding to review the reforms recommended by the Presidential Commission on the Postal Service. On Tuesday, the Committee heard from representatives of the printing and magazine industries, small catalogue retailers, weekly and daily newspapers, and the Postal Rate Commission's Consumer Advocate. We discussed not only the Commission's workforce and financial recommendations, but also the Postal Service's mission and monopoly, the rate-setting process, and corporate governance issues. Today we will continue our focus on the mailing industry.

As our witnesses well know, the Postal Service is the linchpin of a $900 billion mailing industry that employs 9 million Americans in fields as diverse as direct mailing, printing, publishing, catalogue production, and paper manufacturing. The health of the Postal Service, therefore, is essential to thousands of companies and the millions that they employ. It is vital that we in Congress, the Postal Service, and the mailing industry work together to save and strengthen this institution upon which so many Americans rely for communication and for their jobs.

I welcome our witnesses today and look forward to hearing their views and insights on the recommendations of the Presidential Commission.

I would now like to welcome our first panel of witnesses. Mike Eskew serves as the Chairman and Chief Executive Officer of UPS, the world's largest package delivery company. Under Mr. Eskew's direction, UPS is expanding its capabilities into new lines of business that complement the company's global package delivery operations. Prior to serving as Chairman and CEO, Mr. Eskew served

as both Executive Vice President and Vice Chairman. He has served as a member of the UPS Board of Directors since 1998.

Our second witness this morning is Fred Smith, who is the Chairman, President, and Chief Executive Officer of FedEx Corporation, a $23 billion global transportation and logistics company. Mr. Smith provides strategic direction for all FedEx Corporation operating companies, including FedEx Express, FedEx Ground, FedEx Freight, etc. He founded FedEx in 1971. Today the company serves over 214 countries and handles more than 5 million shipments each day.

We are very pleased to welcome you to the Committee. We appreciate your both taking time to come in person, and, Mr. Eskew, we will ask that you begin.

TESTIMONY OF MICHAEL L. ESKEW,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER, UNITED PARCEL SERVICE

Mr. ESKEW. Chairman Collins, good morning. I am Mike Eskew, Chairman and Chief Executive Officer of UPS, and I am pleased to be here today to testify on behalf of the men and women of UPS on this important issue of postal reform. I have a written statement that, with your permission, I would like to submit for the record.

Chairman COLLINS. It will be entered.

Mr. ESKEW. And I will summarize that statement with just some brief comments this morning.

Madam Chairman and Members of the Committee, I appreciate your efforts on this important issue. The Postal Service is an impressive organization and has some great things going for it: Inspired leadership from Jack Potter and his team, incredible dedication of the people in the field, and an infrastructure designed to deliver core mail services that are second to none.

In the past, UPS and the Postal Service have been at odds with respect to postal reform. However, more recently both organizations have made great strides in trying to find common ground on a number of issues. Many of our team from several functions across UPS have gotten to know the Postal Service, and Postmaster General Potter and his team have gotten to know us. And these efforts have led to relationships that we hope will continue to grow.

We think it is a credit to both organizations that we have been able to meet with some level of success by working together where it has been mutually beneficial. UPS is in an interesting position with respect to the Postal Service. On the one hand, we are large customer of theirs. We use the Postal Service as our primary means of communication with our employees, our shareholders, our customers, our vendors, and others. UPS is responsible for over $230 million annually in revenue to the Postal Service, and as I have said before, we are now working together with them on a number of fronts. And, on the other hand, we are perhaps one of the few companies in the Fortune 500 that has the Federal Government competing in our core market, the package delivery business. I believe there is a path to postal reform that will enable the Postal Service to continue to provide high-quality core mail services to ev-

[1] The prepared statement of Mr. Eskew appears in the Appendix on page 129.

eryone in America. This path should include provisions that ensure that the monopoly is not leveraged into the competitive marketplace. Indeed, the Bush Administration highlighted this concern when it issued its statement that any reform measure must ensure that the Postal Service "operates appropriately in the competitive marketplace."

The path to postal reform should focus on the following key areas: A clear focus on core mail services; a strong, effective regulator; cost control, cost management, proper cost allocation, along with financial transparency; and, to the extent that the Postal Service competes with the private sector, it should be on a level playing field. I will elaborate on those four.

First, reform should focus on core mail services provided by the Postal Service: First-Class mail, standard mail, and periodicals. These services provide the Postal Service with 99 percent of its annual volume, 86 percent of its annual revenue, and covers 92 percent of the overhead cost of the organization. Competitive products do not represent the way out of financial troubles for the Postal Service. Electronic alternatives to hard-copy mail pose a far greater threat to the Postal Service than does competition from private delivery companies like ours.

Second, because the Postal Service retains its statutory monopoly, the public is best served by a strong, effective regulator. Strong, up-front regulation is simply the price for going to market with a statutory monopoly. I want to point out, however, that I agree that the current rate-setting process is in need of improvement. I do not believe, however, that effective regulation and improvements to this process are mutually exclusive.

Third, the Postal Service and the Postal Rate Commission should have the tools needed to establish and maintain the clear, transparent financial picture of the Postal Service. Additionally, the Postal Service should continue to enhance its focus on cost control and set up its efforts to proper cost allocation to its various products.

Fourth, and finally, to the extent that the Postal Service competes with the private sector, it should be on a level playing field, and that the Postal Service should not leverage its monopoly network into the competitive free enterprise marketplace. Because core mail services cover nearly all of the overhead costs of the Postal Service, competitive products essentially get a free ride on the postal network. Neither UPS nor any other private company has the benefit of a statutory monopoly to cover the lion's share of its overhead cost. This clearly represents an advantage to the Postal Service.

Additionally, the Postal Service enters the competitive marketplace with other benefits associated with its government status. It is exempt from many taxes and exempt from a number of laws that apply to the private sector. Just last month, the U.S. Supreme Court found in the case of *U.S. Postal Service v. Flamingo Industries* that the Postal Service is indeed part of the Federal Government and, therefore, it cannot be subject to antitrust laws. In its decision, the Court stated that the Postal Service has many powers more characteristic of government than of private enterprise, including its state-conferred monopoly on mail delivery.

To be fair, the Postal Service also has its burdens placed on it as a result of its public mission that do not fall on private sector companies. This fact is recognized by the Supreme Court in the Flamingo case as well. These advantages and the burdens should be recognized and reconciled.

I believe there is a path to reform that will accommodate the Postal Service, its employees, its customers, and its competitors. I look forward to working with you and your staff, Madam Chairman and Members of the Committee, to ensure the Postal Service remains strong and viable into the future.

Thanks so much, and I will be happy to take your questions at the appropriate time.

Chairman COLLINS. Thank you very much for your testimony.

Before turning to Mr. Smith for his statement, I would like to call on my colleague, Senator Voinovich, to see if he has any opening statements he would like to make.

OPENING STATEMENT OF SENATOR VOINOVICH

Senator VOINOVICH. Thank you, Madam Chairman. It is a short statement.

I want to thank you for continuing your thoughtful probe into the recommendations made by the Presidential Commission. I applaud your efforts to address this issue and for your commitment to finding solutions in a bipartisan manner.

There is a bipartisan agreement that we need a strong, viable Postal Service. Whether it is delivering needed supplies to a business or a birthday card to someone's grandmother, the Postal Service exists to serve the needs of every American.

Ohio is the home to significant urban areas, major U.S. cities, including Cleveland, Columbus, Cincinnati, Toledo, and Dayton. However, much of Ohio is rural, and for people who live in rural areas, the Postal Service provides a vital communication and economic link to the rest of Ohio, the Nation, and, for that matter, the world. I know that rural Ohioans were concerned that universal service, guaranteeing affordable rates and frequent delivery, could be scaled back. I am pleased that the Commission strongly endorsed continuing this long-standing mission.

Ohio's business community has shared with me their support for postal reform including RR Donnelley, which maintains a large presence in Ohio, testified before this Committee on Tuesday, and the American Greetings, which is headquartered in Cleveland. But it is clear that the U.S. Postal Service faces serious challenges. While it is impressive that the Postal Service has reduced its level of indebtedness to the U.S. Treasury from $11 billion in 2002 to $7 billion today, this is still a significant amount. In addition, the Postal Service carries approximately $48 billion in unfunded retiree health benefits and about $6.5 billion for unfunded workers' compensation benefits.

Furthermore, the Postal Service faces increased competition not just from commercial firms like the gentlemen who are here today and their companies, but also from rapidly expanding technologies such as e-commerce and online bill paying.

In addition, we cannot ignore a new challenge facing the Postal Service, and that is the challenge of securing our Nation's mail. My

colleagues and the entire congressional community know this reality all too well after the horrific anthrax attack in October 2001. We are still getting our mail 2 and 3 weeks late. I have to tell people to mail items to our regional offices because of the process that mail must go through here.

This tragedy was even more personal to the postal community. I visited with postal employees in Toledo and Cleveland after the anthrax attack to talk with them about their fears and assure them that we would do what was necessary to protect them. That is another burden the Postal Service carries today, and I know we are working to try and make sure that they are working in a secure environment.

Madam Chairman, I thank you for calling this hearing. I thank the witnesses for their testimony before the Committee today, and I look forward to continuing to hear the views from our witnesses today. Thank you.

Chairman COLLINS. Thank you. Mr. Smith, would you proceed with your statement?

TESTIMONY OF FREDERICK W. SMITH,[1] CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, FEDEX CORPORATION

Mr. SMITH. Thank you, Senator. I, too, have a written statement which we have submitted to you, and I am going to summarize it if that would be acceptable.

Chairman COLLINS. Without objection, all written statements will be submitted in full.

Mr. SMITH. Senator, on behalf of 245,000 members of the FedEx team, we appreciate very much the opportunity to give you our thoughts on this important issue.

FedEx supports the modernization and the transformation of the U.S. Postal Service. We support S. 1285, which has been proposed by Senator Carper, with some recommended amendments.

We urge further study in regard to developing a fundamental transformation plan for the Postal Service for the future to look at the pros and cons and the methods of turning the Postal Service into a corporation owned by the government or by private interests, and to determine the best method to unwind the monopoly that the Postal Service enjoys by the end of 2008, which is consistent with the European Union timetable, and in a manner most suitable for the Postal Service.

Now, we are very familiar with the requirement to transform a business. FedEx itself has been dramatically transformed over the last few years from a largely domestic express transportation company to a major diversified transportation logistics and business service corporation.

The Postal Service is likewise at the proverbial fork in the road. Its main income comes from letters, most of which will eventually disappear. And as Peter Drucker has noted, we are sort of like the 1820's, the same status in terms of the Information Revolution as the Industrial Revolution was at that time, so there is more change ahead.

[1] The prepared statement of Mr. Smith appears in the Appendix on page 138.

So the basic choice for the government is relatively clear. On the one hand, you can liquidate in an orderly manner or close down the USPS as technology encroaches upon its primary business. Or you can structure an entity that can compete.

Now, FedEx favors allowing the USPS to compete because at the end of the day it is politically not feasible to simply ignore three-quarters of a million U.S. citizens employed by the Postal Service. And the management of such a decline and liquidation would be extremely difficult. One only has to look at the experience of Amtrak to see how difficult that truly is. But none of that detracts from the issue that the Postal Service needs fundamental transformation. I think it was best summed up by David Walker, the Comptroller General of the United States, when he stated that the "incremental steps toward postal transformation cannot resolve the fundamental and systemic issues associated with the Service's current business model."

The Presidential Commission recommended making USPS into a world-class business, but it should be obvious that the USPS must first become a business before it can hope to become world-class. A regulated government monopoly cannot become a world-class business. We at FedEx certainly could not have transformed ourselves into the entity that we are today had we had a board of political appointees, regulated prices and operations, and a monopoly. So serious study is needed of the pros, cons, and options for transforming the USPS into a corporation.

Likewise, the USPS cannot learn to compete unless it is required to compete. A monopoly is dispiriting and enervating. A serious quantitative plan to phase out by the end of 2008 should now be developed, in our opinion. Postponing repeal beyond 2008 could delay EU reform to the detriment of U.S. express and direct marketing companies. And I would just point out in that regard, one of the serious concerns I know on the part of FedEx, and I suspect on the part of the United Parcel Service as well, are the European monopoly postal services who have been allowed to come into private industry and use those funds to help them compete against our operations.

FedEx would recommend an increase in USPS management flexibility, much more flexibility in pricing of their competitive products, an end of salary caps for executives to ensure the best possible talent. We would like to see a ceiling on the scope of the postal monopoly, say 12.5 ounces or 6 times the stamp price, and divesting the USPS of the administration of that monopoly because it is fundamentally unfair.

We favor firewalls, which is the term that Congressman McHugh used over on the House side, to prevent unfair competition, a separation of USPS accounts into non-competitive and competitive, a required allocation of a reasonable level of overhead cost to competitive products, an end of key legal privileges for competitive products, such as the antitrust exemption, an assumed Federal income tax on USPS competitive product revenues.

We recommend strengthening the Postal Rate Commission, giving it subpoena power, extension of jurisdiction to international mail, annual oversight of rates, and increased enforcement powers.

We recommend allowing the Treasury and USPS to create a government corporation to handle the back office, transportation, and sorting in a truly businesslike manner. Such operations should be nonpolitical and performance based, and a government-owned corporation working only for the USPS would not pose competitive issues.

The monopoly reforms need to be refined in minor respects, authorizing the Postal Rate Commission to adopt regulations clarifying the scope of the postal monopoly, and exempting outbound bulk international mail from the monopoly.

You should consider authorizing, in our opinion, the Postal Rate Commission to phase in access to mailboxes in a controlled manner that does not hurt the USPS or households.

And we think that you should adopt basic common-sense guidelines for international postal policy. You should not allow the USPS to charge less to deliver foreign mail than American mail, except perhaps for correspondence from the very poorest companies. And we recommend that you not allow the UPU's Committee of Postal Officials to legislate international regulations binding on the U.S. Government or courts.

And, finally, we recommend you exempt bulk business letters from the requirement of a uniform rate for all letters, which is about half of all letters. Universal service should be preserved, but allowed to evolve with changing times. No political or economic reason whatsoever, in our opinion, remains to require uniform rate for bulk business mail, and we recommend that you give the USPS maximum operational freedom consistent with maintaining universal service.

That concludes my comments, Senator, and obviously I would be happy to answer any questions that you might have.

Chairman COLLINS. Thank you very much.

Before turning to questions, I would like to call on my colleague, Senator Carper, for any opening remarks that he may have. As many observers are well aware, Senator Carper and I have committed to joining together to draft a bipartisan postal reform bill. We hope that bill will be enthusiastically embraced by all of our colleagues.

Senator CARPER. At least by George Voinovich. [Laughter.]

Chairman COLLINS. Senator Carper.

OPENING STATEMENT OF SENATOR CARPER

Senator CARPER. Thanks very much.

Mr. Smith, I understand that when I was just about to walk into the room, you said some supportive things about the legislation that I introduced this past year, and maybe, Madam Chairman, if Mr. Eskew comes in and supports it as well, we could just go right to the markup on that bill.

Chairman COLLINS. I don't think so. [Laughter.]

Senator CARPER. I didn't think I would get you on that.

Chairman COLLINS. Nice try.

Senator CARPER. I have a statement for the record that I would like to submit, and we are just delighted that you are here. We have had, really, a series of excellent hearings, and I think given the lineup that we have here today, we are going to get a lot out

of it, and I look forward to marking up the Collins-Carper-Voinovich bill some time in the next couple of weeks. Thank you.

Chairman COLLINS. That is right.

[The prepared statement of Senator Carper follows:]

PREPARED STATEMENT OF SENATOR CARPER

By all accounts, the Postal Service has been a success since its creation. It receives virtually no taxpayer support and the service its hundreds of thousands of employees provide to every American nearly every day is second to none. More than thirty years after its birth, the Postal Service is a key part of the nation's economy, delivering to more than 200 million addresses and supporting a massive mailing industry.

Even a casual observer, however, could see that the past few years have not been easy for the Postal Service. As we learned earlier this week, they have also been difficult for the private firms, large and small, and the millions of mailing industry employees who depend on stable postal rates.

I am pleased, then, that we have a once-in-a-generation opportunity now to work in a bipartisan way to modernize the Postal Service and update its business model for the 21st Century. Congress has been at work on postal reform for nearly a decade now, mostly in the House under the leadership of Congressman John McHugh from New York. This year, however, I sense that we have some momentum that hasn't been there in the past.

At the end of last year, President Bush issued a set of postal reform principles focused on those recommendations from his postal commission aimed at improving transparency and accountability at the Postal Service and giving management the increased flexibility they need to streamline operations and seek out new mail volume. His principles touch on the main themes addresses in S. 1285, the comprehensive postal reform legislation I introduced last June. S. 1285 itself was based in large part on the most recent postal reform bill put forward by Congressman McHugh.

I think it's safe to say, then, as I've said before, that we probably have agreement on 90 percent of what should be in a new postal reform bill. Now that this committee's schedule of postal hearings is nearly complete, I look forward to sitting down with you, Madam Chairman, and all of our colleagues to begin putting that bill together.

Chairman COLLINS. Thank you, Senator.

Thank you both for your testimony. As competitors of the Postal Service, your views and experience are very important to our deliberations as we review the Commission's recommendations and sit down to draft a bill.

Mr. Eskew, during your presentation to the President's Commission, you testified that the package delivery sector is well served by private companies, and some observers felt that you implied that the Postal Service should not compete in this area. Some observers have felt that both UPS and FedEx's goal is to get the Postal Service out of the package delivery service.

Earlier this week, we heard from both small and large retailers, for example, a small company in Maine called Cuddledown, a larger company that owns Harry & David, who testified before us that their companies could not exist without the Postal Service, even if they are customers of yours as well.

Would you please comment on the issue of whether UPS believes the Postal Service should get out of the package delivery business altogether?

Mr. ESKEW. Yes, Madam Chairman. My comments to the Commission was that philosophically we believe that the package business in the United States is well served by the private sector, and we think that this country was founded on the free enterprise system that really has made it the envy of the world in terms of the

things that we do and the things that we bring to market. And to the extent that we do service very well, completely, the package business, we think philosophically that the government does not need to be in there, that we serve the needs of the public very well. Practically, they are in this business. Mr. Smith talked about the 750,000 people. So we think to the extent that they do compete in this business, it needs to be on a level playing field, and that is what we have practically been talking about. So that is the first part of your question, I hope.

The second part, just to think about—I am not sure about the small company in Maine or Harry & David's comments about the Postal Service. But quite frankly, I would agree that the Postal Service is absolutely necessary to be able to ship out catalogues and bills and the things that we rely on them to do. Also, we could not exist without a strong Postal Service. So to that extent, I think that is real.

To the extent that they are talking about parcels, on the other hand, though, we service all the State of Maine, from Calais to Corea to Presque Isle to Greenville, and every village, every town, every hamlet, every street in the United States, and we do not stop at the mailbox. We go to the door. We go to the porch. And there is an awful lot of these customers that tell us, "You're the only one to come to the ranch," or "You're the only one to come to the farm," in parts of Ohio and Maine and in Delaware and all over the United States. So we do service the whole country in terms of parcels.

Harry & David's parcels are heavy. They are pears, they are apples, they are rosebushes. They do not fit in the mailbox. And in those places where they do not fit in the mailbox, they go back to the post office. A postcard may be left in the mailbox, and the person would come to get them. We deliver them all the way to the door. And if for some reason there is a pricing differential, I think that is the whole competitive landscape that I like to talk about in terms of level playing field, because those heavy parcels are not part of the in-trace, in-sequence part of what the letter carrier finds on his tray with the next stop that fits nicely into the mailbox—and should not carry any overhead burden. Those things require overhead burden.

Chairman COLLINS. Doesn't UPS rely on the Postal Service for the delivery of packages in certain areas?

Mr. ESKEW. Madam Chairman, we have two million daily pickup accounts in the United States, some infrequent, some every day. We have two accounts, two of the two million, one per million, that we have an experimental pilot program where we are using the Postal Service to deliver about less than 20 percent of the volume we pick up from those two accounts. Those two accounts' packages fit in the mailbox, a place that we, as Mr. Smith mentioned, do not have access to. If we could have access to those mailboxes, that 20 percent would be much less.

But those two customers that we use the post office to deliver less than 20 percent, a very small piece, are satisfied with the slower services and less than—the visibility that we provide with the total services that we offer, and so we do use the Postal Service for those two accounts.

Chairman COLLINS. Thank you.

Mr. Smith, in some ways, your testimony seems to go even beyond Mr. Eskew's when you refer to the difficulty of winding down an organization that employs some 750,000 individuals. I want to clarify what your position is since I do not think you really are endorsing the dismantling of the Postal Service, if it were practical, but perhaps you are. But what is your position on whether the Postal Service should be in the parcel delivery business?

Mr. SMITH. Well, Senator, let me clarify the first point there. What I was trying to say, perhaps not as clearly as I meant to, is that the Congress of the United States has two choices. Technological trends are such that you can either decide to liquidate the Postal Service because that is what is going to happen if you don't do anything. Technology is going to basically fundamentally change it. Or, secondarily, you can modernize it. We support the latter completely. And in that regard, some of the things that we have recommended, not dissimilar to what Mike Eskew said, are that the Postal Service divide its competitive and monopoly products into two buckets. And those competitive products have to bear an appropriate level of the overhead and the cost structure of the Postal Service.

If you really look at the practicalities of the situation where the Postal Service shines compared to the private delivery companies like UPS and FedEx, both of whom serve every address in the United States the same way the Postal Service does, it is in those very small, particularly lightweight packages that can be commingled with letter mail. When the Postal Service has to have a completely separate delivery structure or an off-route delivery by letter carrier, that is not a marginally costed activity. And if you divided the Postal Service along the lines that we mention in here, into competitive and non-competitive products, and had the competitive products bear an appropriate level of the cost, my guess is the marketplace would solve all this on its own. And that is why we support the bill that Senator Carper authored and a companion bill over on the House side which is headed in that direction.

So we do very much support the modernization of the Postal Service.

Chairman COLLINS. Thank you. Senator Carper.

Senator CARPER. Thanks very much.

Just look forward, if you will for us, 10 or 15 years—and think about when Ted Stevens was a freshman Senator, he held hearings—I do not know that they were so much in rooms like this, but he actually shared with me once that he held breakfast meetings, I guess at his house here in the Washington area, back in 1970, 1971, had people over for breakfast and they talked about what kind of changes were needed in the Postal Service. And out of those breakfasts—maybe we should start serving breakfast at these. I don't know. But out of that series of breakfasts came sort of the foundation for the changes in the Postal Service that have endured for over three decades.

I don't know that anything we will come up with will have that kind of life span, but just look forward for us, and I am sure in 1970 they did not know we would have an Internet, the kind of

changes that we see in the delivery of information. My guess is that no one was even thinking about it then.

But look forward ahead for us 10 or maybe 15 years and tell us what kind of postal system, delivery system, including your operations, what are we going to have? I am asking you to be futurists and look ahead. What do you think it will look like 10 years from now? Let's go in alphabetical order.

Mr. ESKEW. When we think about the future in our business—and then perhaps I will come back to the Postal Service—we really think that it is goods and it is information and it is funds. It is all wrapped together. It is commerce all over the world in a much more global perspective than perhaps we think about it now. So it is going to allow companies like ours to be certainly one to one, each package as if it is the only one we have, each customer as if it is the only one, and it will be much more tailored and much more one to one with our—and that information about the goods moving through our networks allow us to do those kinds of things. So that is where I think that we are headed.

Now, when you think about letters and documentation, Mr. Smith said it the right way, I think, that certainly the Internet and electronic transmissions, e-billpay, those kinds of things are going to go much further and much easier and much more—as younger generations age, it is going to be much more well received than it is today. And it is going to be much more practical to use it because it is going to be part of the process of ordering, payment. It is all going to be the virtual process of one touch, the bill gets cut, the bill gets paid, it is all electronic, it never gets reduced to paper and never finds its way into the Postal Service.

Senator CARPER. All right. Mr. Smith.

Mr. SMITH. Well, we have gone under a very simple premise for a long time, and that is that whatever can be moved electronically eventually will be moved electronically.

Now, that threatens, if you will, a great part of the existing First-Class mail monopoly that the Postal Service has. I think virtually all of the invoicing that currently moves through the postal system will go to an electronic format simply because the cost/benefit ratio is enormously favorable. I mean, you can go online and find an invoice that you owe and pay it for a few cents, where the overall transaction cost of producing an invoice, mailing it, mailing back in a check is well over a couple of dollars. So just the efficiency of that will lead most institutions to go to an electronic invoicing system. Most of the personal communications that are written today have gone, of course, to E-mail.

Now, I think on the other side of the coin, however, the Postal Service actually has a huge business opportunity in the future because what the Internet and cable TV are actually doing are balkanizing the broad communication systems in this country. You know that from the political campaign business.

So the Postal Service has a tremendous advantage in that it is a product-push organization rather than a customer-pull type situation that the Internet is. If you are interested in looking at something on the Internet or buying something on the Internet, you have got to go on it and search it and find it. The Postal Service can reach out to specific slices of society like no other institution

in terms of advertising, promotions, publications, catalogues, and then that in turn will create a tremendous amount of traffic going into homes and businesses, some of which the Postal Service, if it is reformed along the lines we suggested, can compete for and hopefully there is a significant amount of business there for FedEx and UPS and other private competitors.

So I am quite optimistic that there is quite a good business for the Postal Service, but only if it is reformed and can encourage and incent that business, and then on the other side of the coin is required to cost account for competitive products in a way that you do not get this muddled situation that they have today about what is really costing what and what this should cost versus that. So that is our view.

Senator CARPER. Thank you. Talk to us a little bit about corporate board structure. Look at your own corporate board structure. Look at that that exists in the Postal Service with the Board of Governors. I think in the President's Commission they had recommended that we have a board of 12 members. I think the Postmaster General would serve along with three people, nominated by the President, confirmed by the Senate, and then they would go out and select from others in the country, eight or nine others to serve on the Board of Governors. They would serve 3-year terms, not 9-year terms. There would be age restrictions; I think no one could serve over the age of 70. I think there would be a requirement that, for people to serve on the board, they would have to have had some experience in the enterprises that relate more or less to what the Postal Service does.

Those are recommendations in the President's Commission, and looking at your own operation, the way your own board operates the way you select your members and what we are going to be trying to figure out with the Postal Service, what advice would you have for us?

Mr. ESKEW. Again, with any board in our governance, transparency is the rule of the game, and we need to make sure that anything that the board of our companies is fully transparent, fully reported, fully able to be audited and applied to all the proper commissions. And that is a big part of any part of governance for the Postal Service in the future.

In terms of the board makeup, independence may be a little bit difficult because there are so many people that have so many contacts with the Postal Service. That may be a bit problematic.

Senator CARPER. Everybody is a customer.

Mr. ESKEW. That is right. That may be a little bit difficult to do, but certainly independence and proper oversight and transparency, the same type things that we do with our boards.

Senator CARPER. Mr. Smith.

Mr. SMITH. Well, based on my experience both at FedEx and serving on five other New York Stock Exchange companies over the years, I would say that the fundamental requirement for a good director of the USPS or any other large commercially oriented enterprise is business understanding and business knowledge. A person might not understand the particular details of the business, but if they understand how a commercial enterprise operates in general, they can generally provide good input to that organization.

The second thing that they have to have is independence. In our particular case, there is only one insider on our board. All the others are independent directors and always have been. I think at one time we had two insiders on the board, so it is one out of 13. And I think that the second criteria is to have strong, independent directors. And the third, just as Mike Eskew said, is that you have to have a board that is willing to and insists upon a great degree of transparency to the various publics that oversee and depend upon the Postal Service.

Senator CARPER. I might say, Madam Chairman, this issue of transparency that they both come to, when we talk about the issue of whether or not the Postal Service would have the ability in the future to use the profits from their monopoly operation to cover some of the overhead that relates to their competitive products, to the extent we could have good transparency, it would help ensure that that kind of thing does not happen.

Chairman COLLINS. Thank you, Senator Carper. Senator Voinovich.

Senator VOINOVICH. First of all, I would like to say that I do not have the benefit of the time that the Chairman of this Committee has had in studying the report of the Presidential Commission. I apologize if some of this may sound redundant. First, would you clarify if you are suggesting today that the Postal Service get out of those areas where they have high cost drivers and where the private sector is getting the job done.

One of the concerns I have—and I am sure the public has—is that if the Postal Service withdrew from some of these competitive businesses, it would impact pricing. For example, if I am American Greetings or I am a big mail house like Donnelley or a mail order business like Harry & David, there is a concern that they are going to end up with one railroad and not have competition. As a result of that see their costs go up because there isn't any competition. What are your comments on this?

Mr. ESKEW. Senator, I will start. When we think about price and we think—the Postal Service has a number of different products, but I will simplify them into two. They go to market with a monopoly set of products and products that compete with the private sector. And when they go to market with that monopoly set of products, then the burden is to make sure that the cost is allocated and priced properly and it is managed properly and transparency is all there.

The Postal Service has been able to allocate to each product about 60 percent of the cost. About 60 percent of the total cost is attributed to the product, and the other 40 percent is left over in overhead.

Think about what happens with the 40 percent that is left over in overhead. To be able to partition those, they mark up each of those sets of products. In the monopoly part, if they mark those up by 69 percent, an extra 69 percent applied over and above the attributed cost a monopoly might——

Senator VOINOVICH. In other words, you are saying that the Postal Service uses one part of its business to subsidize other parts.

Mr. ESKEW. Well, they do mark up the monopoly products by 69 percent, only 28 percent in the competitive side. Two and a half

times as much is marked up in the monopoly side that is protected. So that is something that when you do go to market and when you do have those kinds of markups that are two and a half to one, that gives us some concern. It is the price of going to market with the monopoly and competitive products, is proper oversight, proper regulation, proper reporting, proper transparency, and proper regulation up front.

Also, if you think about who suffers because of that and you talk about prices, it is the captive First-Class user who, we believe, pays the price for the overall system. And so cost burden is shifted, and depending upon how that cost is cut up.

Senator VOINOVICH. So you are saying that the First-Class customers are subsidizing the inefficient operations of other business lines? Are you saying the Postal Service should get out of those inefficient operations? Don't you think that if they did, the costs of UPS and FedEx would go up substantially?

Mr. ESKEW. We have a lot of great competition that we have to watch. We have to earn our business every day. And I did not say get out. I do think it just needs to be on a level playing field, and that attribution measurement certainly needs to be evaluated much more carefully, and more than 60 percent of it needs to be attributed to each product, and the way it is marked up beyond that needs to be studied.

Senator VOINOVICH. Well, I want to say to both of you that I am a customer, and both outfits do a very good job, and I congratulate you on that.

The other issue I would like to ask about is the issue of management. We have had the most revolutionary change in the last 25 years in the Title 5 dealing with the Federal workforce. And both of you have had an opportunity to observe the postal management and how it is organized.

In terms of just fundamental business practices, empowering people, training, giving employees the tools they need to get the job done, what are your candid thoughts about the management?

Mr. SMITH. First, Senator, let me just clarify what you said to the question that Mike Eskew answered. We have not recommended that the Postal Service get out of anything. What we have said is break it into two parts, the monopoly and the competitive, and the competitive should be required to allocate appropriately the cost when it is competing with private industry, because, otherwise, you end up with someone subsidizing someone else. It is just that simple. And there is a great social experiment that has been going on for the last 10 years that shows what happens when you get oblivious to those types of fundamental business principles, and it is what has happened in Europe. It is incredible that these postal monopolies have been able to take these enormous protected monopoly cash flows and been able to diversify into competitive businesses, which earn a fraction of the returns of the noncompetitive businesses.

Now, whose interests have been served? Only one, and that is the management of those regulated businesses over there.

So we do not propose anything other than what I just mentioned, dividing it into two parts.

Regarding the management, it is first-class, and the management of the Postal Service, particularly in the last two administrations of Postmaster General Henderson and now Postmaster General Potter, are as fine business executives in transportation and distribution as I have seen anyplace. And I think the common denominator there is that both of those Postmaster Generals, as opposed to the political appointees before, really understood the operations and the issues of the Postal Service as an operating entity. And the political appointees, while they were fine folks and some of them personal friends, simply did not have that level of knowledge.

So the Postal Service is extremely well managed, in my opinion, and it is because of that fundamental change that took place with Postmaster General Henderson's appointment.

Chairman COLLINS. Thank you, Senator Voinovich.

We have been joined by Senator Stevens, who probably knows more about the Postal Service than any Member of the Senate, and we are very pleased he could find the time to join us this morning.

OPENING STATEMENT OF SENATOR STEVENS

Senator STEVENS. Thank you very much, Madam Chairman. I am delighted to be here, and I am delighted that you are holding these hearings. With the Postal Service and the two gentlemen at the table, I think you are talking about three of the largest employers in my State, as a matter of fact. So the scope of this hearing is really, I think, most interesting to us.

Unfortunately, I cannot stay because I have got an appropriations hearing, but I did want to come by and pay my respects to Mr. Smith and Mr. Eskew and the people that work for them, as well as the Postal Service. I think the recent changes in our economy show that we really have to find some way to bring about a better balance in this, and I congratulate you and the Committee for holding these hearings.

There is no question that the scope of the mailing industry is changing, and its tasks are becoming just overwhelmingly difficult really to balance all the interests involved.

I look forward to working with you and Senator Carper and the Members of the Committee, Senator Voinovich, in trying to find some answers to some of the questions that are being raised here. But I do not have any questions for them. I, instead, have thanks because I do not think we could get along very well in Alaska without the Postal Service or the services that FedEx and UPS provide to our citizens. I am happy to have a chance to just drop by and say hello.

Thank you very much. As a matter of fact, I think FedEx is the largest employer in my home town, so I am glad to see you here, Fred. Thank you very much. [Laughter.]

Chairman COLLINS. Thank you, Senator Stevens.

I want to thank both of you for taking the time to come testify personally. You both represent outstanding companies, and I think we can learn a lot from your experience. So we hope you will continue to work with the Committee as we proceed down the road of postal reform.

Thank you very much for your testimony.

I would now like to introduce our second panel of witnesses.

Gary Mulloy is the Chairman and Chief Executive Officer of ADVO, Incorporated, the Nation's largest targeted direct mail marketing company based in Windsor, Connecticut.

Gary Pruitt is the Chairman, President and Chief Executive Officer of the McClatchy Company, which owns the *Sacramento Bee,* the *Minneapolis Star-Tribune,* the *Raleigh News and Observer*, and he appears today on behalf of the Newspaper Association of America, which represents 2,000 large newspapers plus a number of weekly newspapers. Mr. Pruitt serves as Chairman of the NAA's Postal Committee.

Robert Wientzen is the President and Chief Executive Officer of the Direct Marketing Association which represents 4,700 member companies, both commercial and nonprofit, including numerous catalogue companies and direct mailers. Mr. Wientzen has over 30 years of experience in the marketing industry. In his position as President and CEO, he is responsible to the DMA Board of Directors and oversees all facets of the organization's work.

Mr. Mulloy, we will start with you. You may proceed.

TESTIMONY OF GARY M. MULLOY,[1] CHAIRMAN AND CHIEF EXECUTIVE OFFICER, ADVO, INC.

Mr. MULLOY. Thank you, Madam Chairman. I am pleased today to represent the 3,700 associates of ADVO who serve 20,000 small and large clients across the United States. We are the largest user of standard mail, and we spend about half a billion dollars a year in postage. We are proud to be the constituent of the Ranking Member of the Committee in Connecticut, and we also have facilities in the States of most of the other Members of the Committee as well.

I would particularly like to thank Chairman Collins and Senator Lieberman and the entire Committee for your work on Public Law 108–18 which attempted to address the Postal Service's CSRS funding issue. One of the key events of that effort was a request by Senator Lieberman for a report from the GAO. I thank the Senator for his initiative on that effort and for the commitment of every Member of this Committee to see that CSRS funding is corrected.

As a result of that law, the Postal Service has promised to hold rates steady until at least 2006. Following three rate increases in an 18-month period, this respite came at a critical juncture for the Postal Service, our industry, and the economy as a whole as it prevented another rate increase and therefore created a window of opportunity for this Committee and Congress to thoughtfully consider postal reform.

In the letter I received from the Chairman and Ranking Member, I was asked to address a wide array of reform issues being considered by the Committee. In response, I have submitted written testimony. I will summarize certain parts of my written submissions today.

I am going to focus today on a topic that is not always considered exciting, and that is accounting. This Committee and the Congress

[1] The prepared statement of Mr. Mulloy appears in the Appendix on page 161.

should address this issue in a comprehensive manner. The issues I am talking about here are related to the retirement and health care benefits which have actually been mentioned this morning already.

If we would put the Postal Service on a truly transparent and more clearly understood financial footing by addressing these issues, we would then empower all other reforms to, in fact, succeed. In addition, proper accounting of these benefits would allow the Postal Service to keep its commitment to its employees and retirees; that all pension and retirement benefits and health benefits are paid, now and in the future; and the Postal Service will be able to offer its customers an extended period of rate stability that would allow it to take advantage of our now recovering economy to grow volume and revenue for the Postal Service and improve the financial health not only of the USPS but our industry and the overall economy.

As one of the Postal Service's largest customers, I can confirm the GAO's comments that predict spiraling, increasing rates will continue to drive business, volume and revenue away. Non-competitive pricing that creates higher than necessary postal rates 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 our own private delivery services as alternatives and as a necessary hedge for fear of continuing rising postal rates. If postal rates were established, maintained, and managed in a more market-oriented, efficiently run system, private industry would use the USPS more, and both the Postal Service and industry would experience growth.

Our current strategy calls for us to double our business in the next few years. This will be done by expanding the geographic coverage and increasing the frequency of what we do. This expansion could bring significant additional business to the Postal Service. However, we have already begun shifting a significant portion of our business to alternate delivery. In just the three markets where we currently conduct our own private delivery system, we are delivering mail pieces that have more advertising, are heavier in weight, with equal readership and response to what we deliver through the mail, and are achieving savings of over $6 million per year compared to the cost of using the Postal Service. Unless changes are made, much of our future growth will continue to be shifted away from the Postal Service and into the alternate deliveries.

Now let me give you a glimpse of a different scenario. Extending the current period of rate stability beyond 2006 would allow us to be even more aggressive in our expansion because we would have the confidence that our largest single cost would be contained. We have the latent ability to create 3 billion additional packages. Importantly, we would be able to plan our growth in a rate-stable environment.

Continued rate stability would benefit the mailing industry, the Postal Service, and the economy as a whole. This is no overstatement. The volume generated by this hiatus in rate increases, coupled with the impact of the important reforms this Committee is

considering, would set the Postal Service on a positive course for the next generation. On the other hand, frequent excessive rate increases, such as the three that were implemented from the beginning of 2001 until mid-2002, will decrease business and lead to the fulfillment of GAO's prediction of spiraling declines in business.

Stable rates coupled with comprehensive reform are not a pipe dream. This Committee can help lead the Congress to make them a reality. Since 1971, the Postal Service has been required to break even by charging mailers its cost of operation. The USPS has not been chronically losing money or breaking even in its operation, despite what many people have said. In fact, since it was created, the Postal Service has generated an operating profit, and a handsome one at that.

Since 1971, postal revenues have been billions of dollars more than the cost of handling postal operations. Even if Congress were to force the Postal Service to book 100 percent of its health care liabilities today, the Postal Service still would have generated billions more in excess revenue through rates charged mailers and consumers in the past and still in place today.

That money has gone to the Federal Treasury. 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 Treasury. This important first step was only a partial, temporary solution and included some provisions whose effects were not known by this Committee and Congress and that were not in the best long-term interests of the Postal Service.

In implementing last year's action to correct the CSRS overfunding, the Office of Personnel Management made a very material accounting change to the existing 33-year methodology that substantially reallocated to the Postal Service some of the government's responsibility for its share of the pensions earned as a result of work performed by postal workers 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 they 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 for each year of employee service. Using that methodology, the Postal Service has, as of today, even with last year's changes, actually overfunded the CSRS liability by $81 billion. However, that fact was masked when OPM, after discovering this overfunding thanks to Senator Lieberman's GAO request, responded by quietly adopting a new allocation method that shifted much of the pre-1971 obligation to the Postal Service, to the detriment of postal customers. Instead of an $81 billion overfunding, the USPS was told the obligation was still underfunded by $4.8 billion.

Interestingly, congressional language in Public Law 108–18 established a method by which the USPS could appeal the change of the pre-1971 allocation to the CSRS Board of Actuaries. The USPS

has filed that appeal. They make the case in that appeal that the original allocation method used for 32 years was fair and recently determined to be consistent with sound, common practice in both the public and private sectors by the Hay Group, a well-respected actuarial firm commissioned by the Postal Service.

The USPS has a sound and well-substantiated case. However, the three-member, OPM-appointed board has not heard an appeal in its 84 years of existence. It is unclear what timeline or method will be applied to the USPS appeal. You have the opportunity to take control of that process and codify the former methodology in legislation, acknowledging postal customers have been grossly overcharged over the years, and make the operating and financial performance of the Postal Service clear and transparent as a productive base from which to implement other areas of reform.

In addition, part of last year's legislative fix of CSRS was a new requirement that the Postal Service pay military, Peace Corps, and other government retiree benefits. This transferred an additional $28 billion in charges. We would suggest, along with the Presidential Commission, that that requirement be removed.

We believe that this Committee can put the Postal Service on the road to financial health if you fix the problem of the allocation of retirement benefits carried before 1971, transfer the military benefits back to the Treasury, and release a portion of the identified overpayments from the escrow created last year. These actions will make prefunding health care possible and eliminate the Postal Service's debt to the Treasury. In addition, the Postal Service would have funds for needed capital expenditure, and it can provide additional years of rate stability going forward, that will, in fact, encourage revenue and business success for the Postal Service.

We believe this resolution is fair to postal workers. We believe it is fair to the Postal Service. We believe it is fair to the consumer, and we believe it is fair to our industry that, in fact, relies on the Postal Service for its livelihood.

Thank you for your time.

Chairman COLLINS. Thank you. Mr. Pruitt.

TESTIMONY OF GARY B. PRUITT,[1] CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, THE MCCLATCHY COMPANY, ON BEHALF OF THE NEWSPAPER ASSOCIATION OF AMERICA

Mr. PRUITT. Thank you, Chairman Collins, Senator Carper, and Senator Voinovich. Thank you for the opportunity to share the views of the newspaper industry on the important issue of reforming the U.S. Postal Service. As mailers since the birth of the Republic, newspapers want and need a healthy and vibrant postal system for generations to come.

The Newspaper Association of America encourages this Committee to take a comprehensive and fresh approach to postal reform, including addressing the difficult yet critical issue of cost control. NAA supports most of the recommendations outlined by the bipartisan Presidential Commission, and my written statement provides a summary of the industry's position on all of the major

[1] The prepared statement of Mr. Pruitt appears in the Appendix on page 169.

issues addressed in the Commission's report. The main focus of my testimony is pricing flexibility, an issue of particular concern to newspapers.

First, I would like to take a moment to describe how newspapers use the Nation's postal system. Throughout our history, newspapers have served as partners with the Postal Service in its mission to bind the Nation together. Congress has consistently recognized the important role newspapers and other periodicals play in our Nation's postal system.

Newspapers today are among the leading local users of postal services and, collectively, we spend well over $700 million on all classes of mail, particularly in periodicals and standard mail. And because we collect the majority of our revenue from subscriptions and advertising revenue through the mail, we also have a special interest in first-class.

Newspapers, whether large or small, daily or weekly, serve as vehicles for news and advertising. Generally speaking, there are two kinds of newspaper advertising. One is commonly called "Run of Press" or ROP, and it appears on the page of the newspaper. The other is called "pre-prints," and they are free-standing inserts that we either put inside the folded newspaper or mail to non-subscribers.

Newspapers compete with other Postal Service customers, particularly saturation advertising mailers, for both types of advertising. Unfortunately, over the years this competition with other mailers has served as a source of considerable friction between newspapers and the Postal Service. Newspapers do not believe that the Postal Service, an agency of the Federal Government, should take sides in the marketplace competition between one mail customer and another. Regrettably, our experience has been that the Postal Service has, in fact, chosen to favor our advertising competitors through pricing strategies and new initiatives targeting the advertising revenues upon which we rely to support news and editorial content in our products.

In its 1998 marketing plan, the Postal Service clearly presented its goal of harming newspapers in favor of advertising mailers. It said the service would "create the platform for moving substantial revenues from pre-printed newspaper inserts into the mail."

Since this declaration, Postal Service actions have spoken louder than words. It launched an ill-fated $10 million market test called "Auto Day" that set out to divert automobile advertising from the *Milwaukee Journal* and into mail. Last year, in Iowa, the Postal Service employees made sales presentations to newspaper advertisers encouraging them to move their business out of newspapers and into direct mail. Finally, the Postal Service continues to advance the misperception that it is in the direct mail business. An example is its description in its 2002 Transformation Plan in which the Postal Service describes saturation advertising mail as "low hanging fruit" it seeks to increase, needless to say, at the expense of newspapers.

While our concerns about the Postal Service choosing sides in the competition for advertising among mailers dates back more than two decades, we have been encouraged by the recent actions of Postmaster General Potter and his management team as they

refocus the Postal Service on its core mission of mail delivery. We applaud their efforts, and we want to work with them as customers.

Congress has heard from large mailers and the Postal Service that they want pricing flexibility and that that is key to the Postal Service's financial future. We encourage you to examine these pleas carefully. There is a big difference between improvements that benefit all mailers, making the process of changing rates simpler, more efficient, and more predictable, and certain changes that would allow large influential mailers to get special deals for themselves. High on the wish list for pricing flexibility is the ability to enter into so-called negotiated service agreements, or NSA's, with individual mailers.

Although newspapers are often the largest mailer in a local market, we strongly oppose NSAs because we believe they unfairly favor the largest mailers with deals made by a government entity. Government services, here postal services, should not be based on negotiating or lobbying skills. I urge the Committee to support that principle.

Newspapers believe strongly that NSAs for the benefit of individual mailers should be abandoned in favor of work-sharing arrangements that are available to all mailers, both large and small, who meet predetermined criteria for those rates, and that such discounts should be based on cost savings. By working with all mailers, the Postal Service would earn a far better return on its investment of time and effort than if it spends its energy and resources to negotiate special deals with individual mailers.

While we oppose NSA's for individual mailers, we agree that the current ratemaking process is too lengthy, too litigious, and too expensive. NAA supports the creation of an expedited rate-setting process that would also protect mailers from unjustified or flawed rate proposals before they are implemented.

The Presidential Commission has recommended that the Postal Service should be allowed to set rates within certain limits established by an enhanced Postal Regulatory Board, and under this approach, rate ceilings could rise no more than inflation, and within a rate index, the Postal Service would have flexibility to make annual rate adjustments without going through the current lengthy Postal Rate Commission process. At the same time, mailers would be protected from large and frequent rate increases. NAA supports this type of pricing flexibility.

Newspapers believe, though, that even with this revised system, mailers should be given at least an opportunity to challenge postal rates before they are implemented upon a complaint that a particular rate is flawed or discriminatory. Such a system would not cause delay in a proper rate change as the Postal Service must give mailers time to modify their mailing software to implement new rates. But it would provide an appropriate safeguard.

Newspapers also agree with the Presidential Commission that with pricing flexibility must come enhanced oversight to ensure that the Postal Service operates properly as a public service. In particular, NAA supports the Presidential Commission's recommendation to give an enhanced regulatory body the authority and tools to ensure that the Postal Service is appropriately allo-

cating its costs across its competitive and non-competitive products and services. The regulator in a separate proceeding should establish the methodology used for calculating and allocating costs and should be given necessary tools to compel the Postal Service to produce cost data. A more accurate and fair system for measuring and allocating costs should be a prerequisite of any reform measure.

NAA appreciates the opportunity to provide the Committee with our views on postal reform and specifically on the issue of pricing flexibility. 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 look forward to working with this Committee on comprehensive postal reform to improve this essential public service.

Thank you.

Chairman COLLINS. Thank you, Mr. Pruitt. Mr. Wientzen.

TESTIMONY OF H. ROBERT WIENTZEN,[1] PRESIDENT AND CHIEF EXECUTIVE OFFICER, DIRECT MARKETING ASSOCIATION

Mr. WIENTZEN. Chairman Collins, I am Bob Wientzen, and I am President and CEO of the Direct Marketing Association. On behalf of the 4,700 members who are direct and interactive marketers—and, by the way, that includes about 350 nonprofit companies or entities that use mail to raise charitable funds—I want to thank you for having us involved in these hearings. We consider this to be a vital issue for our industry, and, in fact, for its 9 million employees. This is the key to our continuing to be able to grow and be part of this economy.

Now, I also believe that direct marketing is, in fact, a vital interest to the future of the Postal Service as well as the economic and social interest of the country. Our business has about a $635 billion impact on the economy, and our nonprofits, in fact, raise about $50 billion a year through the mail. That is an important part of the social services part of the Postal Service's contribution to the fabric of this country's economy and its social work network.

So we are talking about a major element of the economy and, in fact, over 50 percent of the Postal Service's revenue from both mail and parcels, a very important distinction.

From the outset, I want to tell you essentially what I told the Presidential Commission, and that is, I do not believe that you can find a solution to this problem without someone's ox being gored. It is that simple. I do not think you are going to be able to find a way out without achieving less than that desired by some of the interested parties.

My biggest fear at the moment is that the Washington drive to compromise will, in fact, produce a bill that ends up either not being effective or not being effective over the long term. And that view is shared by some of our larger members, who are worried that, in fact, we will not have a long-term solution coming out of this process. So that we want to acknowledge up front, that this is a tough one for you all to be dealing with.

[1] The prepared statement of Mr. Wientzen appears in the Appendix on page 183.

I want to cover a few of the key points that are covered in detail in our written testimony.

Flexibility to set rates—clearly we think that the keystone of this legislation needs to be the ability to set increases on the part of the post office that are no more frequently than yearly and that are at or below the rate of inflation or the actual cost, whichever is less. To us that is sort of a bottom-line basis.

We think that the post office and certainly us, the mailing community, need to be set free, as Mr. Pruitt and others have indicated, from this cumbersome and unbelievably costly ratemaking process that we now have before us. We also believe that the post office needs to have clear flexibility to achieve negotiated service agreements.

On work sharing and workforce flexibility, another key point, I believe that any solution needs to build on the 25 years of work-sharing experience that we have. We agree with the GAO. We are saving $15 to $17 billion with the work-sharing agreements we have now. That is more than the discounts that are being provided. The post office needs the flexibility to continue that program. It also needs the flexibility to right-size its labor force and its infrastructure. There is no question about that. It has to be able to match the marketplace demand for its services, which is—as you heard earlier and we certainly agree—going to continue to change.

Now, that may mean a smaller internal workforce over the long term. I suspect it does. We think that can be handled by the significant retirements that we are going to see over the next 6 years.

Also, modest adjustments in the current collective bargaining process may be in order. Specifically, we think we should be seeing required mediation and, very importantly, restricting arbitration awards to be prospective rather than retroactive. We do not see any sense in that system.

Arbitrators, further, should be required to consider the current marketplace conditions in their findings. This is a changing communication world, and we think arbitration simply has to take that into consideration.

Regarding workers' comp—I agree with the Presidential Commission. An injured worker should receive the pension level that he or she would have ended up with had they not been injured. It is not comprehendible to me that somebody would end up with a bigger retirement having been injured versus somebody who served an entire career. And, Senator Collins, I know your staff is working with the employee groups on some of these issues to find ways to improve the collective bargaining process. We applaud you publicly for that. We know that is not simple. We would encourage you and we want to commit to being helpful in any way that we can in that regard.

Let me make one additional point in that regard, and that is, we think there should be a continued effort to find ways to work with the employee units to increase volume. There is not enough talk of that, and some of them are working with us to try to find new ways to increase volume versus simply talking about cutting costs.

Regarding universal service—we certainly support its continuation, and we think it ought to be reviewed periodically as the world changes. One important point, however, is we do see a con-

tinued need for a parcel delivery service component on the part of the Postal Service. It is vital to our members. Many of them depend on it, and it does provide a competitive base, and I think most of you realize that we believe that it is part and parcel of the work of keeping the system competitive.

Now, two final big points regarding civil service retirement issues—we strongly agree with the Commission on this issue, and effectively we would say to you let's make it right, let's do it clearly, and let's do it as soon as possible. There is no logical reason to continue the current funding of military retirement benefits by the post office, no logical idea that we have heard advanced, and we should not force mailers to fund an escrow account or in any way continue the mistakes of the past in that regard. Again, do the right thing for the post office's future. And, Senator Collins, I know your initial bill did not include that escrow provision.

To conclude, direct marketing is about arithmetic. It truly is. It is that simple. While we are a big industry, it is about the numbers. We use mail rather than use E-mail when mail works. We use mail rather than space ads when mail works. And, increasingly, there are competitions. We know that. Raising postal rates, to my knowledge—and I have been in the business a long time now, raising postal rates has never raised response rates. And, in fact, that has made the Postal Service less competitive with these other media. If we continue to raise them, we will make it even less competitive in the future. It is that simple.

When the math says it no longer works, people now switch to other things, and they are increasingly doing so—a week does not go by that I do not have a meeting about issues of E-mail or wireless communication and so forth. And, in fact, if the mail continues to go up, we are going to see much more effort to use less of it.

So I think this bill is going to have to end the death spiral that we have of increasing rates and diminishing volume. And I commit the Direct Marketing Association certainly to continue to work with all of you and ask that you really think of the fact that this bill, if it even comes close to the effort Senator Stevens and others made that was referred to earlier, is going to have to last us for a long time. We really need it to be effective.

Thank you very much.

Chairman COLLINS. Thank you, Mr. Wientzen.

Let me start by responding to some comments that you made in which you expressed some skepticism about whether Congress will produce a comprehensive and effective bill. We would not be holding this, our sixth hearing on postal reform issues, if this were not a serious endeavor to produce a bill that does not just nibble around the edges but, rather, will be a comprehensive effort. I see the Commission's report as presenting an opportunity that will pass by if we do not act. And a great number of the Members of this Committee have been very active in this effort. So our goal is the kind of comprehensive and effective bill that you seek as well.

In that regard, aside from the issues of fixing the escrow account, which you correctly noted was not in the original bill that we authored here in the Senate, and the military retirement issue, what provisions do you believe are absolutely essential to make sure this is an effective, comprehensive bill?

Mr. WIENTZEN. Well, certainly as others have indicated, the ratemaking process is really the keystone to, we think, the future. If we limit rate increases to the rate of inflation—I personally favor the rate of inflation minus some productivity factor. That aside, if we limit those increases, then, in fact, we will have a systemic reason for the Postal Service to be more responsive to the marketplace demands. And I think that will be very important. So that, I would say, is a key issue.

The issue of being able to right-size both the workforce and the facilities, I think, is the second issue that we simply have to find a way to depoliticize that. We have to find a way to allow the post office adequate flexibility. The post office is doing a great job. We think that we have a marvelous post office. We really do. But, in fact, the fear is that they are going to be hamstrung from continuing to be able to deliver a competitive product if they do not have the ability to right-size both the workforce and the facilities.

Those are the two big points I would advance to you.

Chairman COLLINS. Thank you.

Mr. Pruitt, in your testimony, you said, "Newspapers agree that the current ratemaking process can be too lengthy, too litigious, and too expensive." You also say that, for good reason, Congress has never granted the Postal Service both a legal monopoly and pricing freedoms, and you go on to say that Congress should take pleas for pricing flexibility with a healthy grain of salt.

I would like to explore this issue further with you because it is an absolutely key issue, and many of our witnesses have said exactly the opposite. They said without the ability to adjust rates, without a short-cut to the 18-month rate-setting process, the Postal Service just is never going to become agile enough and responsive enough.

If Congress were to give the Postal Service more pricing flexibility, should the Postal Service be able to set whatever rates it wants? Should it have a cap? Should it have a review process before the fact or only one that is triggered after the fact upon complaint? Could you explain what you think should be done in that area now that we know your concerns.

Mr. PRUITT. Sure. I will do my best, and to the extent that I am not complete in my answer, let me know.

We do think the current process is not effective—too expensive, too lengthy, too litigious. So we do, in general, support the Presidential Commission's recommendation on price flexibility and the indexing mechanism.

Our concern there is that—and the way we would like to see that work is it would be indexed, say, to inflation or cost, whichever is lower, however it works, the rate announced, and would be put into effect unless there is a complaint, at which time the Postal Regulatory Board would quickly review and make sure it is fair, and the rate would be imposed. That is not unlike what the FCC used to do when they were administering rates and fees on telecommunications. There would be a rate announced, and without objection—and there usually was not—it would go forward. If the rate is within the indexed amount, I do not think there would be many objections.

But as the Presidential Commission pointed out, there are different postal functions that are used in each class of mail, so it does not necessarily follow that each will go up with inflation or each will go up at the same level or at the same time. Our biggest concern here is we do not want First-Class mail subsidizing standard mail. We do not want a cross-subsidization going on, and if there is an after-the-fact review, we fear that there will be damage in the marketplace with advertising and business switching in a fiercely competitive marketplace that an after-the-fact review and refund system will not adequately address.

And so we are concerned with an after-the-fact review, but we do think the Presidential Commission is on to something with an appropriate amount of pricing flexibility within an indexing mechanism.

With regard to NSAs, our concern with NSAs is that we do not think an essential public service should negotiate with individual customers for a price break. We do not think that that is the best or fairest or even most cost-effective way for the Postal Service to address this issue. We think what they should do is get the mailers together and establish work-sharing criteria for all of the mailers and have input from a wide array of mailers, it will be a better return to the Postal Service. It will be fairer.

If you have an individual negotiation, that individual mailer will seek to have terms that may be particularized or individualized to its company, and that will be unfair to the other mailers who are not a part of this negotiation. I think it will be subject then to litigation and claims and not have an adequate return on the effort that the Postal Service is engaged in to create the NSA.

Senator Carper has incorporated some safeguards into his proposal with regard to NSAs which I think are quite encouraging and wise. But we still have concerns that hopefully can be addressed.

I do not want to go on too long, but I hope that addressed most of those questions. I would be happy to follow up if you would like.

Chairman COLLINS. Thank you. Senator Voinovich.

Senator VOINOVICH. Mr. Mulloy, you made reference to the accrued liabilities of the Postal Service. You think those need to be tackled, $48 billion in unfunded retiree health benefits and $6.5 billion for unfunded workers' compensation costs? In other words, this is a ticking time bomb, and you are concerned if we do not face that forthrightly that down the road you are going to see these things just skyrocket.

Also, this is news to me. Did you say that the Postal Service subsidizes the Treasury of the United States. Is that correct?

Mr. MULLOY. Yes, Senator. Essentially what has happened is that overcharges have been assessed to the Postal Service over the years. The Postal Service has charged excessive rates and those monies have been turned back to the Postal Service and then back to the Treasury in a way of assessed retirement benefits payments that were, in fact, not necessary. In effect, therefore, the Treasury has been subsidized by the Postal Service by incorrect assessment of retirement benefits payment obligations.

Senator VOINOVICH. So what you would say is that that should be looked at very closely and start to direct those dollars, instead

of going into the general fund, toward dealing in a responsible fashion with these accrued liabilities. That would be interesting.

Mr. MULLOY. Yes, sir, it would.

Senator VOINOVICH. Because our accrued liabilities for retirement and health care in the Federal service, as you know are enormous. We do not have the funds in many of these accounts, and then when these retire, we have to take money out of the income that comes in. It is a pay-in, pay-out type of a system. And you are suggesting that, like any business, you must put the money aside and deal with funding retirement benefits in a responsible fashion.

Mr. MULLOY. Exactly, Senator. I would add that unfortunately, in most commercial entities, the accrual for retiree benefits is not necessarily 100 percent secure, as we all know, even in the commercial world; and that, in fact, with what the Postal Service has paid, for the last 30 years or so, is in an enviable position, to actually deal with all these issues at one time if we, in fact, look at that as a totality.

Senator VOINOVICH. Well, the problem is that, like so many of the other trust funds, there is nothing. We have spent the money.

Mr. MULLOY. Right.

Senator VOINOVICH. We say it is there, but it is not. So that is something that really would need to be done over a period of years in order to make it right.

Mr. Wientzen, you were saying something about competition. I asked a question earlier of the other two witnesses about if the Postal Service got out of parcel delivery, you would not want that to happen.

Mr. WIENTZEN. No, Senator. We think that would be a serious problem on a couple of fronts.

First, a large number of our members really do depend on the parcel delivery service of the Postal Service. We are large customers, and many of our members are entirely dependent on the Postal Service for their parcel delivery.

Of course, we have a number of members who are delivering——

Senator VOINOVICH. Will you tell me, which members?

Mr. WIENTZEN. Well, I was just going to say, we have a number of members who are delivering smaller parcels—books, CDs, software, and so forth. Oftentimes, they are finding that the Postal Service is absolutely cost-competitive and they provide an adequate service.

Beyond that, there are many of our catalogue members—and you heard, I think, an earlier firm, a couple of them—who find that the Postal Service's products are cost-competitive, that they are adequate for their needs and the Postal Service does a good job.

I think finally we have a very serious concern that if the Postal Service were to either be pushed out of the business or to have encumbrances that make it less competitive, that, in fact, you would see prices being driven up by UPS and FedEx, good business practices that they would be, would simply move prices considerably higher and that would be bad for our members and bad for the customers that they serve.

I do not know why so many people think that, for example, our industry, let's take just the catalogue part of our industry, has switched over to the private delivery services. They have not. There

are many who use both, and we have a fairly good number who use principally the Postal Service. And I will tell you, many of them are not unhappy, again, with that value proposition, the cost and the quality of delivery.

Senator VOINOVICH. The question is are you happy with that service being subsidized by other customers of the Postal Service?

Mr. WIENTZEN. Well, it is a fair question, and I would argue, we do not think it is. We think that there is adequate protection in place at this point. But, beyond that, I would ask you to think about this: Does United Parcel charge all of its customers the same rate? No. We know they do not. In fact, I can tell you, having been on the other side, that you can sit down and negotiate with United Parcel or with FedEx, and depending on your volume and what you want and where you are and how much business they have and a lot of other factors, not just your size, you can come out with a different price.

Now, I would argue, if I come out with a better price than you, are you, in fact, subsidizing me? I think you all have to make a big decision here. Are we going to move this thing more in a direction of the marketplace or not? And, yes, if you do move it in a direction of the marketplace, are there going to be a few inequities here or there? Yes, maybe so. But as long as they are not significant and serious, I think you have to decide to move it in a direction of a freer marketplace situation. If the post office can do a good job at a reasonable price and agree that they do not use the monopoly as the principal way of subsidizing it, I think we have to open that up, frankly.

And I would also say to you that we think opening it up to other private delivery services, be they domestic or foreign, is not inappropriate competition. We are not afraid of that.

Senator VOINOVICH. So you would say that you think they ought to have the flexibility to look out at the marketplace and look at what their costs are and what others are, and understand that in totality to compete.

Mr. WIENTZEN. Well, I do. And I would say if you look carefully under the hood, you would discover that there is one form or another of "unlevel playing field" all over the place. Do the private delivery services use other businesses to subsidize delivery? They have leasing businesses that, in fact, are less profitable than the delivery service. I suspect that in today's world, we are going to see a lot of that. I grant you that government services are different, but the big decision you all have to tussle with is: Do you move this Postal Service further away from being a government agency and more into the private marketplace, competition world?

Senator VOINOVICH. My time is up.

Chairman COLLINS. Would you like to——

Senator VOINOVICH. I would just like to mention one other thing.

Chairman COLLINS. Sure.

Senator VOINOVICH. We got into the issue of the workforce in terms of needing flexibility, and as I mentioned earlier, we have tried, working with the Chairman of this Committee, to make some real changes in Title 5, for our civil service. The concept is to work harder and smarter and do more with less; to pay for performance and give agencies flexibility to bring in people, for example, and

paying them more than what the Federal Government says you can pay because they need the experts, but just giving them a lot more flexibility.

It has not been easy because there is some real concern in terms of the employee unions, and I would like you to further comment on that issue. I know the Chairman has been working with the unions. We are trying to come up with something that they feel is going to be fair. But from your perspective, are we too inflexible in terms of our operations, in terms of human resources?

Mr. WIENTZEN. Well, certainly you are less flexible or the post office is a lot less flexible than the private sector would be, and the fact is that that is where the competitive pressures are coming from. So the answer is certainly yes, there is a lot less flexibility.

I do think that you have made some progress. I think we should acknowledge that. There is some great thinking going on, and we are feeling generally positive. I will also tell you that we are working with some of the unions in a much more cooperative and proactive way. And we are seeing some different focus by a number of those folks who do recognize now that there is going to be a significant drop in the volume of mail at the post office. And if we do not have more flexibility and they do not join in on that, we are not going to have jobs one way or the other.

But there are lots of things that you can do yet. For example, I think preserving seniority if the trades move between one kind—because that is going to have to happen, I suspect. To have those inflexible silos like we have now is going to be really a problem down the road in the next couple years. You are going to have to have more flexibility there. I think the grievance process and some of those kinds of things need to be less bureaucracy oriented and faster. They need to move along, less incentive for spreading out things. We think the mediation thing I mentioned needs to be—we need to have incentive to move all of these processes more quickly, to make the post office more nimble and able to be competitive. It is not now able to really be as competitive as they want to be or they would be if we took some of the bureaucracy away from the structure that they are having to deal with.

Senator VOINOVICH. Chairman, are the demographics the same in the post office as they are in most of the other Federal agencies in terms of this large group of people that are going to be retiring that could make it more easy to do some of the things that Mr. Wientzen suggests?

Chairman COLLINS. Absolutely. Forty-seven percent of the postal workforce will be eligible for retirement within the next 10 years. So the workforce reforms, in my judgment, do not translate into the need for large-scale layoffs. I think a lot of the right-sizing can be done in a compassionate way that takes advantage of the aging workforce in the sense that they are eligible, going to become eligible for retirement. So I think a lot of the reforms that need to be instituted can be done in a way that creates a positive working environment, and I know that has been the Senator's concern as well.

Mr. WIENTZEN. And if you look at the detail of the numbers, even within 6 years of—while we say a decade, if you really look at the numbers, within the next 6 years you have got a tremendous opportunity within that time frame to make a very significant dif-

ference. We just have to take sort of the boundaries of some of the things that the post office would do in terms of shifting people around and so forth.

Chairman COLLINS. Thank you, Senator.

Mr. Mulloy, I want to talk to you because you have a very interesting perspective. You are both a very large customer of the Postal Service, but you are also a competitor. You described in your statement that in three markets you have gone to an alternative delivery system.

One of the issues that the Committee is debating is whether or not the Postal Service should be allowed to compete in areas where there are private sector providers. As you are well aware, the Postal Service has had some bad experiences in trying to sell products that really were not part of the Postal Service's core commission, and they ended up being money-losing enterprises.

So, first, I would like to get your view on the issue of the Postal Service competing with the private sector. And second, and a related issue, is whether there are additional constraints that are needed, either statutory or regulatory, to ensure fair competition and to ensure that there is not a cross-subsidy between the monopoly products and the competitive products.

Mr. MULLOY. I think to reply to the first part of the question, I really do believe that we would support and I would support that the Postal Service should be a stronger and more competitive commercial entity. I think with that I am implying that it should, in fact, compete with commercial entities that are conducting the same kinds of businesses.

There should be a charter around the Postal Service in terms of where it should properly focus its attention. Some of the things that were attempted to be done with separating its business into three separate buckets that begin to look at First-Class separately from standard mail and some of the other pieces of the business that it is in, we would support that. But I do believe that the Postal Service should be encouraged to be a competitive entity where it is doing its business.

Our company makes decisions to use our own private carrier delivery system when we think it is economically attractive. I wish that that were not something we needed to do to protect the outlook for rates and the uncertainty of that rate process going forward. If we felt that the Postal Service managed its rates as most commercial entities do, which is setting the caps around inflation, and understanding the way that you are incentivized to manage your business then its customers would have the reliance upon the fact that they are not going to have an inflationary cost, especially when that cost is a major part of the business that they do.

The second thing is that I think there is only a certain amount of regulatory environment you can put around an entity. You cannot legislate out every single thing that might, in fact, be simply a slightly different way of interpreting things. The idea that we need to fairly burden the cost of all parts of the mail system with the cost of doing that part of the mail is something that we would endorse.

That being said, in my 35 years of business, I know that cost accounting is not a science. It is an art. And it, in fact, does subsidize

new ventures for a business. When a company goes into a new business. In the very first company I worked for, in the new product department of a personal care company, they allocated what they called "before fixed overhead profitability." For the first 3 years of the product's life they did not even allocate fixed overhead to that product because it was being invested in as the future growth of the business.

I am not implying that that is done broadly and deeply and arbitrarily, but, in fact, it is a way that businesses look to the future. And if we want the Postal Service to begin to look to the future, it has to be looking at where its business is going to come from and where it wants it to go. And I really believe, as I think even Mr. Smith said earlier, that there is a bright outlook for the Postal Service. I think there is a lot of business to be had, as long as it is encouraged to commercially market itself against the growing product streams that are out there.

Chairman COLLINS. Mr. Pruitt, I would like to ask you a similar question because in your testimony, you gave an example of the Postal Service competing with the newspaper business. And I remember it very well because my newspapers in Maine were very concerned about that experiment as well to pull the newspaper ads out as separate mailers. What are your thoughts on the appropriate role for the Postal Service when there is a private sector provider of the same service?

Mr. PRUITT. I think it is critical, and the Presidential Commission got it right, it is an essential public service, universal service, and in the First-Class and standard mail area, it is a monopoly. And as a monopoly, it has worked well to provide that universal service, and we do not object to that at all.

Our only concern is cross-subsidization, and what we want to ensure is that there is a postal regulator, a Postal Regulatory Board, that has the power to ensure that measures and allocation of costs are fair and appropriate and that the Postal Service's delivery costs are covered within that class of mail. And we do not feel it is appropriate for a government service, a public service, with a monopoly to enter into private agreements with the mailers and give them a price break. That is our concern.

In the competitive areas, I think it is a principle where cross-subsidies are also a problem, but, frankly, our biggest concern is the cross-subsidy in the monopoly areas between First Class Mail and standard mail.

Our experience has been that alternative delivery has not been as effective in our products as mail delivery, and so we have delivery of the newspaper and then we use the mail, and we hope to use the mail, use it efficiently, but with fair pricing.

Chairman COLLINS. Thank you.

Mr. Wientzen, what is your opinion on this issue, which is going to be one of the major issues we tackle?

Mr. WIENTZEN. Well, first, initially, I would probably be one of the few people saying I would let the Postal Service sell Buicks if I thought they could make money on it as a kind of a joke, but I do not believe we can, in fact, unbridle the Postal Service and say go do whatever it is that touches your fancy.

But the problem that you are going to have with this is it is very easy to have a view of the right thing to do today. I think the difficulty is to figure out what is the right thing to do 5 or 10 years from now because the world is changing so rapidly. And if we put the post office in a box and say you can deliver letters and printed material, essentially what you are doing now, and that is it, I think you are going to—somebody, hopefully you, or someone else, is going to be sitting here 5 years from now scratching your head saying we really still have a problem because there has been this significant shift or there has been some new technology.

So I think you have to provide a lot more flexibility, and to me, those who fear the post office just because of competition, I do not think we can listen to them. I think those who fear the post office because they do recognize that the monopoly benefit that they get could be used to create very unfair competition. But that is usually much more narrow than is being described. And I will say we have many companies, some of whom are my members, who would limit the Postal Service even within the business of doing the mail that they do now because it would benefit their particular business model.

I think in your wisdom, you are going to have to give the post office more flexibility than they have, but you are going to have to find some way to provide the private sector for being protected from outlandish subsidization, I think as Gary has pointed out. But if you keep this definition very narrow, I am going to bet that in a few years we are going to have more problems because the Postal Service will not have enough business to continue doing the essential services they are doing.

Chairman COLLINS. Thank you. Senator Voinovich, do you have any further questions?

Senator VOINOVICH. Yes, just following up on your questions.

Chairman COLLINS. Sure.

Senator VOINOVICH. The competition aspect is important to me. I will recall that I ran a utility company when I was mayor of Cleveland, and it was in pretty bad shape when I started. We improved it substantially. Because we existed, we competed with an investor-owned company. The fact of the matter is that the businesses in our community benefited from that because we would offer a price and the competition would offer a price, and it kept rates down. You know, it was very good. Of course, the investor-owned utility did not like it.

So I am real concerned about if we are going to be in a dynamic area, that they should have the flexibility. The question I have is: Do you have in your organization people who are going to have a choice between either mailing something or putting it in a newspaper?

Mr. WIENTZEN. Oh, absolutely, Senator. In fact, the vast majority of my members, I would say 98 percent——

Senator VOINOVICH. So the fact of the matter is you have got a choice of either sitting down with the advertising folks at a newspaper and discussing how much is it going to cost you to put that advertisement in the newspaper. The alternative you have is to mail it and is it more cost effective to do that. And in some instances—I do not know if it happens in your State, but I get a lot

of stuff now that is just delivered at the door, advertising mailers, that type of thing, but usually from local people.

Mr. WIENTZEN. Local people.

Senator VOINOVICH. Tell me a little bit about how that works.

Mr. WIENTZEN. Well, as I say, our business is arithmetic. You sit down and you say it is going to cost this much to deliver this message, and my tests tell me—and we deal in data. My tests tell me that if I do it this way, if I deliver it in a newspaper or I deliver it in mail, here are the response rates I get and here is the cost. I divide it and I say that is within my margin of profit or not. And if it is not, I do not do it. If it is, I do as much as I can of it.

What we are facing is there are new competitions, the electronic ones, which, while the response rates are low, the costs are low. And they are going to continue to be low. Even if they go up, they are going to continue to be much lower. And those are being used more and more as the costs for mail go up. But, in reality, almost every one of our members look at newspapers, magazines, mail, electronic, door-to-door, handing out things in malls, they use all of those techniques when they are economically viable.

Now, the other thing I think you need to keep in mind on the competition point is that the Postal Service has a lot of other burdens to deal with. They have universal service, which, I mean, I think some of the households they deliver are not exactly profitable ones. We know that. And so they have a burden, a competitive burden that they are assuming as a part of this monopoly package that they have taken on. Just as your utility company, I am sure, did some things that a private company would not have done had they not been a public entity. And I think we need to think about that, that that does provide some balance, and maybe there is a little advantage to the public entity that is balanced off by the additional obligations that they have.

Senator VOINOVICH. Well, Mr. Pruitt indicated that he did not like the idea of the Postal Service going out and competing for people that put advertising in the newspapers. I think that is what you said. But if the Postal Service could do that without subsidizing—in other words, that it is an even-steven thing—why should they be prevented from going forward and doing it?

Mr. PRUITT. They should not be prevented from offering the monopoly direct mail service that our competitors can take advantage of and that we take advantage of. We have no objection to that. It is an essential public service. But there are companies like ADVO, other the direct marketing companies and newspaper companies that are in the advertising mail business and take advantage of that service.

What we object to is the Postal Service taking a small portion of its institutional or overhead costs and allocating it to standard mail, and thereby taking first-class institutional costs higher and artificially reducing standard mail costs so that direct mail advertising is being cross-subsidized by First-Class mail. And as a result, it hurts our business because it is not a level playing field. If it were a level playing field with no cross-subsidy, we would be fine. We feel no problem with open competition. But our business is about numbers as well. It is also news and advertising. And if we lose advertising, we lose the ability to produce quality news.

Senator VOINOVICH. Well, would that be the excuse to discourage them from doing that? Is the reason why you do not want them to do it because if they lose their advertisers, the newspapers are going to be hurt in terms of their editorial content and so forth?

Mr. PRUITT. We just want fair pricing, and we feel perfectly comfortable going toe to toe with fair allocation of costs.

Senator VOINOVICH. Your argument is that the First-Class mail people are probably subsidizing their ability to compete and get these folks to come in and be their customers. Is that right?

Mr. PRUITT. That is right. The Postal Rate Commission estimated that 66 percent of institutional costs, that is, overhead, is allocated to First-Class mail and 22 percent is allocated to standard mail, advertising mail. Yet they are virtually identical in volume. It just does not seem fair.

Senator VOINOVICH. The thing is, though, in 2006 rates are going to go up. From what I am understanding, when rates go up it means that you are going to be more likely to look at some other alternative sources than the post office.

What I am trying to say to you, if I am running a business and I keep my costs at what they are today, and there is a little cross-subsidization but I can go out and pick up some more business, why shouldn't I be able to do it?

Mr. PRUITT. Because it is a monopoly, and if it has pricing flexibility to disadvantage other customers as an essential public service and disrupt a competitive advertising market, that seems an inappropriate role for a monopoly government service. If it were in the parcel business, it might be different. I do not really have an opinion there. There is competition with FedEx and UPS and others. But in a monopoly—but in First-Class and standard mail, that is the only game in town, as it should be. But then that means making sure that their pricing is fair and evenly distributed to all customers. Giving a monopoly that pricing power is something we do not allow in the private sector, and certainly I do not think we want to allow it for a government entity.

Senator VOINOVICH. Mr. Wientzen, what is your perspective?

Mr. WIENTZEN. The fact is that we do not think newspapers are bearing the total overhead of the post office that indeed they should or would if you did a direct cost comparison. We do not begrudge them that. We do not suggest that it should be changed because we do acknowledge that there is some special informational value, etc. But we do think there ought to be a balance here. There is already an advantage, in effect, in their acknowledgment of the special case for newspapers. And my suspicion is that we will only handcuff the post office if we continue to put barriers in the competitive front.

I think you are going to have to make a decision and give them more competitive strength than they have now.

Senator VOINOVICH. Madam Chairman, Mr. Wientzen said somebody's ox is going to be gored. [Laughter.]

Senator VOINOVICH. We try not to do that.

Chairman COLLINS. We are just hoping it will not be ours. [Laughter.]

Mr. WIENTZEN. I do, too, Senator.

Chairman COLLINS. I want to thank Senator Voinovich. He always makes such a contribution to the Committee's work, and I appreciate his taking the time to be here today.

I am sure all of us have additional questions. We are, however, in the midst of the budget debate, as you know, and so I am going to submit any additional questions for the record. This hearing record will remain open for 15 days.

[Prepared statement submitted by Senator Lautenberg for the record follows.]

PREPARED STATEMENT OF SENATOR LAUTENBERG

Madam Chairman: Postal reform is an important national issue, but most Americans spend little time thinking about it because they take postal service and the employees who provide it for granted.

The importance of the U.S. Postal Service (USPS) to our national economy cannot be overstated. I'll give you an example: A 2-year delay in postal rate increases has the potential to save publication companies like Time Warner approximately $200 million in mailing costs.

Last year alone, the USPS delivered more than 200 *billion* pieces of mail. So the important role the Postal Service plays in our economy and the contribution of its 843,000 dedicated employees should not be overlooked or taken for granted.

Having said that, this is indeed a time of great change for the Postal Service. As the President's Commission has observed, "traditional mail streams will likely continue to migrate to cheaper Internet-based alternatives," even as the Postal Service's delivery network expands at a rate of 1.7 million new addresses per year.

Given the existing regulatory structure, the Postal Service's debt is likely to increase *every* year, making it tougher for the Postal Service to achieve its fundamental mission of universal service.

Accordingly, it is clear that the Postal Service needs to become more efficient and more effective in fulfilling its universal service goal.

I support the Commission's recommendation to make the rate-setting process less cumbersome and more efficient. Today, the process can take upwards of 10 months; the Commission's recommendations would reduce the rate-making process to 60 days.

I am also intrigued by the notion of increasing work-sharing and private sector partnerships. I would hope, however, that such partnerships are not at the expense of the hardworking men and women of the Postal Service. Improving the Postal Service should not mean gutting its workforce.

Today, I look forward to hearing from some of the U.S. companies that rely on the delivery system of the Postal Service to operate their business. I am also interested to hear from the Postal Service's business partners and competitors about the recommendations of the President's Commission and other postal reform ideas.

Thank you, Madam Chairman.

Senator COLLINS. We very much appreciate this panel's testimony this morning as well as the previous panel. Our next hearing is going to be on March 23, and it is going to be a joint hearing with the House Government Reform Committee, at which the Postmaster General will be testifying. We are going to continue our work and hope to introduce a bill in April that will incorporate all that we have learned at these hearings.

So thank you for your testimony this morning, and this hearing is now adjourned.

[Whereupon, at 11:30 a.m., the Committee was adjourned.]

APPENDIX

Time Inc.

Testimony of Ann S. Moore
Chairman and Chief Executive Office
Time Inc.
Senate Committee on Governmental Affairs
March 9, 2004

Chairman Collins, Ranking Member Lieberman, and members of the Governmental Affairs Committee, 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 Chairwoman Collins, and Senators Akaka and Carper. 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, though not nearly as long as Senator Stevens. 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 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 conclusion that the collective bargaining process needs revision. 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 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. 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, Madam Chairman, for this opportunity to share the views of Time Inc. with the Committee.

Written Testimony

of
Mark Angelson
CEO
RR Donnelley

before the
United States Senate
Government Affairs Committee

March 9, 2004

Good morning, I am Mark Angelson, CEO of RR Donnelley.

I think it is only fair that I tell you that I have been on the job as CEO of RR Donnelley for only eight days. While I have always known how that a healthy, viable and, most importantly, affordable postal service is essential to our country and our economy, when I found out the other day that it costs our customers more to mail a catalog or magazine than it does for us to manufacture it, I knew it was important that I be here today.

As you may know, RR Donnelley is the largest commercial printer in North America and, as a result, that makes us one of the largest users of the U.S. Postal Service; that is because, in addition to being a printer, we also enter well nearly 9 billion pieces of printed material into the mail such as magazines, catalogs, direct mail and highly-personalized statements on behalf of our customers. Customers like Anne Moore of Time Inc. who sits beside me today. Our employees and our customers **see, feel, and experience** the consequences of a postal service in need of reform every single day.

RR Donnelley fundamentally supports the recommendations of the President's Commission and we urge Congress to push ahead **right now** with the necessary changes. If we continue to put off reform, we will no longer be in the advantageous position of passing thoughtful, comprehensive reform but rather we will be reacting to a crisis.

Change is essential to the health of the U.S. mailing industry. I know you have heard the numbers before but they are so compelling, I will say them again. This is a $900 billion industry, which accounts for nearly 9% of the GDP and 9 million jobs.

And just a short word on these jobs: at a time when many manufacturing jobs are at high risk of being done abroad, I can tell you with some certainty that your letter carrier will never be able to deliver your mail to you from overseas. Reforming the postal service is also an opportunity to strengthen a sector of American jobs that stay in America. This hearing today is about so much more than just reforming the U.S. Postal Service. This is about the economy; this is about jobs; this is about the future.

The total postal distribution system, as it stands today, is inefficient. The President's Commission recognized these inefficiencies and now recommends changes. I hope you agree with the Presidential Commission and me, that there is substantial potential for improvement.

However, any piece of legislation that protects the status quo is not acceptable. At its heart, the USPS must change. It must change to allow, encourage and, better yet, <u>demand</u> ongoing improvement. By doing so, the USPS can function more like a business.

With my limited time, I would like to focus on just three areas: worksharing, network optimization, and the CSRS issue.

In today's world, where technology is constantly changing to allow for new improvements, companies cannot and should not do everything. As a result, we have all learned to focus on our core competencies and to rely on others and their expertise of emerging capabilities in order to maximize our performance.

The USPS should do this too. Delivering the mail to and from every address in the United States, six days a week, otherwise known as "Universal Service," is the USPS' core competency; it is simply what they do best. All the rest should be left to those who can do it better. This combination is what we call "worksharing."

Worksharing frees up the USPS to focus on its core, while having others such as RR Donnelley focus on the non-core. This highly-effective combination drives down cost. In fact, according to the GAO, in 1999 alone, worksharing saved the USPS an estimated $15-$17 billion. Yet, and this is a key point, even though there is proof that this works, **it is as difficult today to enter into a worksharing arrangement with the USPS today as ever before.** It is simply is not a widely-accepted practice.

Let me give an example. RR Donnelley and others recently reached an agreement with the USPS on a co-palletization deal. It took 18 months to reach this deal and in the end all we were granted was a three-year trial! That same deal, if it were with a private sector partner, would take 6-8 weeks.

We should not have to work this hard to persuade our partner to reach a result that benefits our customers, the United States Treasury Department, the postal service, and, therefore, all users of the system.

The second area I would like to talk about is network optimization.

It's inconceivable to me that adjustments in the USPS network are not ongoing. The Postal Service's current distribution network was established over 30 years ago, and yet it has remained virtually unchanged ever since. That is astonishing when you think about some of the changes that have occurred during that same period; changes that have had a **direct impact** on how we use and want to use the USPS. From major trends like population shifts, to a rather small invention called e-mail; the country is different now, but the USPS network is the same.

The USPS must be allowed and incented to keep pace with change. Facility locations, size, and transportation routes should be changing **constantly** to keep up with demand, eliminate redundancy and overcapacity, and achieve productivity gains. **All** businesses constantly adjust to changes in customer traffic, demographics or other factors—especially *service* businesses like the USPS. Simply put, the USPS must be **allowed** constantly to re-align its network to reflect current realities, free of emotion and politics. If changes of this nature are not an ongoing, unencumbered process, all the legislation in the world will not make the USPS run better, more smoothly nor more efficiently.

Worksharing coupled with network optimization makes it possible to achieve what we call the "**lowest combined cost.**" This concept is at the core of what RR Donnelley and our customers expect from the USPS.

And, finally, a word on CSRS.

First, I ask that Congress remove the CSRS savings escrow requirements that were created last year. Doing this will free up approximately $73.3 billion that the USPS can use to pay down debt and hold postage rates steady, among other things.

Second, there is no good reason for the Postal Service to bear the financial burden of the CSRS military payments; no other Federal agency is required to do this. If the Treasury does not assume these costs, the result is that they will simply, and immediately, be embedded in the price of a stamp. In other words, mailers (and this includes many small businesses and American families) will be paying the retirement costs of the USPS employees. Let's not make the job of the Postal Service more difficult by keeping this financial weight on their balance sheets.

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. Several more years of "business as usual" could bring us to a point of disrepair.

Thank you.

Testimony to the United States Senate Committee on Governmental Affairs

Christopher W. Bradley
President and CEO
Cuddledown Inc.
March 9, 2004

Cuddledown is a small company located in Portland, Maine. We manufacture down comforters and pillows with most of our marketing done through a catalog we mail through out the United States. We currently have 86 employees. Over the past 15 years we have grown our sales from less than $1 million to more than $20 million. The engine for this growth has been our catalog, and the US Postal Service has been an essential partner in getting our message to our customers. I am here before you representing a small business that is dependent on a functional and affordable Postal Service.

Cuddledown prints and mails more than 10 million catalogs each year. Our annual postage bill is roughly $3 million, but the impact of our business extends beyond that. We print our catalog in Mississippi and we use about 2,000 tons of paper, also manufactured in this country. The total value last year of our payroll, FICA tax, workers comp insurance, life insurance, long-term disability insurance, short-term disability insurance, health insurance contribution, and 401K contribution was $3 million. And like so many mail order companies, Cuddledown is located in a rural part of the country where good jobs are highly valued.

Mail order and the Internet allows small companies to spring-up all over the country, to grow, create jobs, be successful, and to realize the American dream – but the future of this dream now depends on the legislation this committee crafts to reform the Postal Service. Without substantial reform it is expected that we will once again see rate increases far in excess of inflation. The last rate increase in June 2002 raised Standard Mail an average of 8% - for Cuddledown that meant an increase in our postage bill of

$240,000. That's 8 good jobs at $30,000 per job that we would need to cut just to stay even. Given the weak economy, and the job cuts that we have already seen to cope with declining sales, large increases in postage rates will result in small business failures in my industry.

Reform is clearly needed and the President's Commission has outlined the reforms that need to be put in place. In reading the Commission's report and published comments from other involved parties it seems clear to me that reform would include:

- Elimination of the escrow account for overpayments into the federal civil service retirement fund
- Shifting the obligation to pay for military service retirement from the Postal Service to the Treasury Department
- Giving the Postal Service the ability to open and close processing plants and post offices to meet their business demands
- Enabling the Postal Service to use pricing and other services as tools to grow their business

In my opinion, this last point will be the most important in the long run – you must give the Postal Service the flexibility it needs to compete in the current world. The biggest current threat to the Postal Service is the shift from physical to electronic mail delivery. First Class and Standard mail are under attack and mail volumes are projected to decline in future years. The Postal Service must grow the volume of mail, and the only way to do that is to be competitive in today's business world. The current structure of the Postal Service represents the competitive forces of the era when man first set foot on the moon – the structure has been successful for 30 years, but the world has changed and the Postal Service must change to survive.

So what does it mean to be flexible and competitive in today's world? I can think of one example that dramatically illustrates how the Postal Service is stuck in another era and how they can change to increase their mail volume. Cuddledown buys goods and services from hundreds of suppliers, yet the only supplier that does not extend us open credit terms is the US Postal Service. Trade credit is the lubrication that keeps the business world running and growing. The Postal Service needs to compete in the modern business world, and yet their terms are cash in advance as if their customers had no other choice. This policy is straight out of the 1960s, a time when EZ PASS

was science fiction and trying to use your BankAmericard at the grocery store would be met with polite refusals at best.

Cuddledown mails catalogs 18 times each year. The postage is removed electronically from our corporate checking account on Friday, the catalogs begin to move on Monday, and begin arriving in our customers' homes the following Monday. Our average catalog is delivered 12 days after payment has been made. The only competitive part of this process is the electronic debit to our bank account – and that's ironic because it saves us the postage cost of mailing our check.

UPS, FedEx, and Parcel Direct all give us open terms. Our printer, color separator, photographers, and models all give us trade credit. When we buy down or fabric to make our comforters we have standard payment terms. When we sell our comforters, pillows, and sheets to other retail stores we extend them standard credit terms. I can even think of a guy from China who sells us down filled booties – we meet with him in Germany, he's never been to Maine, much less visited us at our factory, and yet he is willing to give us trade credit. Trade credit is reasonable, controllable, and expected in today's world, yet the Postal Service still requires their customers to pay in advance.

Why should you give the Postal Service the ability to extend normal trade credit? Because they could use it to grow their volume. Paying in advance and waiting 12 days for your first results is a roadblock for any business, and especially a small business. Cash flow is critical to a business and many decisions, especially the question of how many pieces to mail, revolve around the impact on cash flow. If commercial mailers could match the timing of their postage payments with the delivery of their mail, they could mail more volume – and they would.

Would trade credit result in significant bad debt expense for the Postal Service? I don't think so. The last supplier that a mailer would fail to pay would be the Postal Service because they would cut-off its source of cash. It would be like failing to pay the phone bill – it just doesn't happen. The Postal Service could easily control their exposure and the marginal cost of mail delivery is low, so the risk of bad debt is low. The risk is low, the reward is great, and the very survival of the Postal Service depends on new ideas that will reverse its declining mail volume.

Extending trade credit is just one idea that will help the Postal Service compete and thrive in today's world. There are probably many others out there and the important thing is that new legislation is passed that will enable the Postal Service to take advantage of the opportunities that are available to it. The business climate in the United States requires constant creativity and innovation just to survive. The legislation that formed the Postal Service in 1970 served it well for many years, but now that same structure is a threat to its very survival. Electronic communication has irreversibly changed the postal world and it is up to Congress to create a new structure that will allow the Postal Service to serve its mission for the next 30 years.

TESTIMONY of MAX HEATH
Chairman

National Newspaper Association
Postal Committee

Before the Senate Committee on Governmental Affairs

March 9, 2004

Speaking for the National Newspaper Association's President Robert F. Sweeney, its Board of Directors and its 2,500 member newspapers, I am pleased to offer this distinguished panel my written testimony and observations on postal reform and the future of community newspapers' relationship with the United States Postal Service. I would like to commend Chairman Collins and Ranking Member Lieberman for bringing up the important matters of postal reform at this time, and to thank Senator Carper for his leadership in having introduced legislation to move the conversation forward. We have newspaper members in your states who are watching the progress of this issue with great interest. We look forward to the bill that will shape this committee's work, and pledge our assistance in addressing issues that affect newspapers.

NNA represents primarily weekly and small daily newspapers across America. I have attached a map showing where our members reside, serving the readers of newspapers that depend upon these publications to help them understand, participate in and improve their communities, and drive commerce. Many of you and your colleagues depend upon these newspapers to help get your messages out to your constituents, and you know that our products are well read from the feedback in your own mailboxes.

As chairman of NNA's Postal Committee, I have worked since 1985 to help our members understand the Postal Service's complex and changing regulations,

and to work with USPS to shape policy so that it can continue as our newspapers' primary circulation partner. Our members are the primary users of within county Periodical mail and also large users of outside county Periodical and Standard Mail—mostly ECR for "shoppers" delivering advertising mail to non-subscribers of our newspapers.

The oft-recited mission of the Postal Service to "bind the nation together" through the delivery of newspapers, letters, parcels and other messages has been reinforced by the President's Commission on the United States Postal Service. I was gratified that the Commission specifically listed newspapers as among the Postal Service's desirable mailstream elements in the future.

While most of our members provide Internet websites for their readers, I do not believe any of them see their print products disappearing within our lifetimes. If anything, as the media landscape becomes more diffuse and Americans rely upon the Internet for personal correspondence, community weekly newspapers become even more important to readers and to the mailbox. Local news websites are few and far between—particularly if you eliminate those provided by our newspaper companies as adjuncts to the printed newspaper. And we actually sell mail subscriptions through our websites.

Therefore, the soundness and viability of the Postal Service is critical to our members. At the same time, a Postal Service that tailors itself only to its largest customers will be of little use to us. Our goal in the coming months is to work with you to ensure that the statutory scheme within which USPS operates remembers us. We need your help to ensure that as USPS strives for greater efficiency and flexibility—elements we essentially agree with—it does not lose sight of its important partnership with local newspapers. We believe all of these ends can be accomplished, without any compromising the others.

We have a history of working with USPS closely in developing mail preparation schemes and work-sharing discounts that makes our mail efficient and desirable. In fact, newspapers were among the first mailers to prepare their mail in the postal carrier's walking sequence—long before discounts rewarded mailers for doing so. While we support much of what we see in the President's Commission report, we have several concerns that I would like to highlight here.

1. **Within county publications must continue to be recognized in the statutory schemes.**

Most within county publications are weekly newspapers, although some local magazines, newsletters and other publications of importance to local communities are also in this mailstream.

Congress shaped the business plans of thousands of newspapers in 1845, when it provided incentives for local papers to circulate within their counties. As the 1970 Postal Reorganization Act took those newspapers into a fully-cost-based future, newspapers began to experience rate shock that would have put many American businesses into bankruptcy. Because our rates had to hurtle from almost fully-subsidized to fully cost-based within about 15 years, the enormity of postage increases caused Congress to act several times to give the industry some breathing room. It took until 1993 for within county rates to settle into rate stability, and most of our newspapers survived the shock and have gone on to celebrate 100 and 110 or 120 year anniversaries in the past decade, thanks to the repeated support of you and your predecessors.

Even so, the increases in postage for within county newspapers from 1970 to the most recent 2002 rates exceed 850%, allowing for all available discounts. [1] Certainly, it has been a tribute to the community newspaper industry that it has

weathered this maturation into fully cost-based rates. Now, postage has grown from an insignificant part of a newspaper operation to 15-20% of some newspapers' operating budgets—a cost that has to be calculated in with the cost of newsprint, journalists and sales staffs, in order to make a viable product. It used to be possible for a newspaper to price a subscription price to cover postage and paper. Now, to do so would put a newspaper out of the range of many Americans' budgets—and newspapers must find other revenues to cover these essential operating costs. Rate increases in the ranges we have seen in recent years—sometimes exceeding 10%--can be enough to wipe out a small newspaper's profit for the year.

The Revenue Forgone Reform Act of 1993, while requiring newspapers to support their own direct and indirect costs, capped the expected contribution to USPS overhead, by setting a ceiling of 50% of the most directly-corresponding commercial rate. In our case, that would be outside-county Periodical mail (which our members also use heavily). The cap, however, has been exceeded consistently in recent years, as outside county Periodical rates have skyrocketed with rising flat mail processing costs. Our within county cost coverage has actually turned out to be higher than outside county in most years. According to the 2002 Cost/Revenue Analysis by the Postal Service, for example, our cost coverage was 102.2%, while outside county mail fell below cost at 90.6%.

My point is that our mail is not inefficient or unprofitable to the Postal Service. It does show a small profit. But it remains less than half of one percent of domestic mail volume and it does require some extra work for the Postal Service to track our costs and volumes separately from outside county mail so our rates can properly cover our costs.

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[1] Without worksharing discounts the rate increases, the increases could be in the 2000% range. More than half of within county mail, however, is carrier route presorted by the publishers, and most of that mail is entered into delivery post offices, requiring no transportation by USPS.

We can easily become lost in the shuffle without your help. But we are an anchor in the mailbox, drawing people there weekly or even daily to read local news and advertising. We will look to the eventual postal reform vehicle to recodify the need for this important periodicals subclass.

Early versions of the legislation in the House on postal reform, as recently as HR 22, included some language that not only anchored the within county classification, but restored status to an older statutory scheme that recognized the importance of small circulations in adjacent counties. We recognize that today's Postal Service does not chart its costs, nor arrange its operations, by a county's political boundaries, and we are open to re-examining the parameters of what is today "within county" mail to better fit USPS's costing systems, provided that we can create a system that is easier for our members to understand and use. But we do believe the voice of Congress in urging the preservation of this mail will be needed as the Postal Service reshapes itself.

2. Negotiated Service Agreements could be hazardous to our health and the Postal Service's health.

NNA has consistently agreed with the Postal Service's efforts to find new incentives for mailers to provide more efficient mail, to use USPS channels for delivery and to add value to the mailbox. We have participated in every niche classification case that involved the mail classes we use, and have supported USPS's initiatives, even if our members did not directly benefit.

We have serious reservations, however, when the initiatives come to incentives directed not just to improving the efficiency of the mailstream, but solely to providing individual mailers with discounts designed to increase mail volumes. We have several concerns about this practice, but among them are concerns for the impact upon smaller market postal customers. We believe that introducing such incentives as the declining rate blocks recently approved in the Capital One

Financial Services NSA will provide large national mailers an unfair advantage in our markets. The likely effect will be to drive smaller volume mailers either out of the mailstream or out of business.

Even the Postal Rate Commission's own Capital One case witness, recognized economist Professor Panzar, acknowledged that the unknown effect upon small volume mailers could put USPS in a lose-lose situation in NSA's. Yet the contract rates were approved.

More recently, NNA urged the Postal Rate Commission—if it was going to continue to permit these sorts of NSA's—to establish some ground rules that would possibly enable a small volume mailer to seek a smaller version of an NSA before a new NSA partner was let loose into the marketplace. We recognize that most NSA discussions include the need for "similarly-situated" mailers to be afforded an opportunity to participate—but our problem is never going to be one of the similarly situated mailer. Rather, we will be the smaller mailer that would possibly be suited to a smaller, customized version of an NSA, and we would need access to that to remain competitive with a large NSA mailer.

Specifically, we asked the PRC to require the Postal Service to use niche classification cases over NSAs when a competitive situation arose so that all mailers could benefit equally. Secondly, we asked the PRC to require that specific cost-savings broken out by cost-segments within USPS's customary cost-reporting framework be reported in a NSA filing. The latter would enable a smaller volume mailer to identify portions of the mailstream where it might be able to participate, and therefore seek a smaller NSA or a "trailer" niche classification, so that it might remain in the marketplace.

It was evident to us that in the Capital One case, its smaller competitors would be affected by that NSA. Many of our members serve community banks, for example, that promote credit cards. None of those banks appeared in the case,

and our members generally reported that it was because their local banks were unaware of it. No doubt they became aware when their customers' mailboxes began to be flooded with Capital One promotional mailers this past year. But did they have any recourse to apply for a similar reduced-postage arrangement? No. Not only have no other NSAs been sought by USPS—even for relatively large competitors of Capital One—there is no meaningful process at this juncture to allow a small mailer to ride along on the largess created by these arrangements.

NNA considers it imperative for Congress to establish some ground rules for NSAs that gives smaller mailers at least an opportunity to participate. Ideally, NSA's with volume incentives would be barred, as they would have been by earlier forms of Chairman McHugh's bill. At the least, however, a NSA must be accompanied by either a work-sharing niche classification or an "NSA-lite" that smaller mailers could use.

I want to make it clear that USPS has agreed with us in principle. The PRC also has agreed in principle, by reiterating its preference for niche classification cases over NSA's. However, intent sometimes weakens with the passage of time, and unless concrete regulations translate these intentions into a specific right for small mailers, our marketplaces could be irreparably harmed.

3. We support many of the President's Commission's recommendations on indexed rates and pricing flexibility.

Having participated in every omnibus rate case since 1970, NNA has had plentiful experiences with the expense and inefficiency of the current process. We are one of the very few remaining organizations representing small businesses that continue to engage in the rate cases. The expense of the cases alone—along with the increasing difficulty in providing meaningful data in an environment where USPS knows relatively little about our mail—is enough to discourage a small organization like ours from involvement.

While no postage increase is welcomed, smaller, more predictable increases are always preferred to major rate shocks. A newly empowered Postal Regulatory Commission, price caps, and reported service standards for all mail classes are among the recommendations that we can support. We believe that the Regulatory Commission does need subpoena power to meaningfully carry out its work—and to shorten the time and lessen the expense involved in protracted fights over discovery, which NNA has experienced in the past. The PRC also must have the ability to gather the information needed to ensure against cross-subsidy.

However, we are concerned about extending the Postal Service a wide berth for increasing rates within a class so long as overall CPI ceilings are not exceeded. Costs and circumstances within a class may vary widely and swing dramatically—particularly for smaller subclasses.

For example, in the R94-1 omnibus rate case, while most mailers were offered a 10.1 percent across-the-board rate increase, the Postal Service's petition for new rates contained a stunning 34% increase for within county mail. Fortunately, with the PRC's leverage and the investigatory work of USPS's statisticians—AFTER the case was filed-- it was discovered that inaccurate costing tallies and improperly calculated mail volumes were at the root of the shocking proposal. Corrections were made before the case was ended and the final result was a 1.5 percent decrease for that subclass. It is hard to imagine what might have happened if there were no PRC to require that re-examination.

Because our within county mail is in a small volume class, USPS has continued to have trouble with statistical measurements. It reports out relatively wide volume swings from year to year in a subclass where we know that circulations and readership are relatively stable. The cause is sparseness in statistical observations—which USPS has maintained is justified for such a small subclass.

Maybe so. But our history demonstrates the difficulty with allowing an unfettered pricing mechanism to operate.

We believe that the pricing indexes need to allow, in some cases, for measurement by subclass. This correction, in conjunction with Congress's continued recognition of within county periodicals as a distinct unit within the mailstream, will provide adequate protection.

4. CSRS reform must continue

NNA worked closely with the Government Reform Committee last year to pass the first phase of reforms of the Postal Service's obligation to the Civil Service Retirement System. (Public Law 108-18) The breather provided by the rate freeze through 2006 enabled small newspapers to recapture some ground lost in the one-two-three punches of rate increases in 2000 and 2001. We appreciated the fast work of the committee in moving the legislation forward, and pledge our continued support in taking the next steps.

It was disappointing to learn that while we achieved temporary rate stability, we somehow picked up a new $28 billion burden for payments of military pensions. The change effectively required ratepayers to assume a burden that belongs to taxpayers, and that is fairly assumed by taxpayers for employees of other government agencies who performed military service.

It was also troubling that Congress mandated an escrow account to begin after 2006 that would require ratepayers to once again shoulder the burdens created by overpayments to the CSRS. Congress asked USPS to report its plans for spending the money in the escrow accounts, and it provided a set of alternatives last September, which included various proposals for recognizing and funding anticipated retiree health benefit costs.

NNA believes Congress should act promptly this year to correct the $28 billion military pension assessment, and to return it to the Treasury. We support the Postal Service's intention for recognizing the retiree health obligation, and we believe the $28 billion that does not fairly sit upon the shoulders of ratepayers would go far in beginning to fund that future obligation. Although we are concerned that the full magnitude of that obligation may still not be recognized, responsible fiscal management requires USPS to begin to plan for it. To do otherwise would be to expose ratepayers to as series of unpleasant and abrupt rate shocks as the Baby Boom generation enters retirement and claims the benefits of the health benefit.

5. The Postal Service should be permitted to right-size its operational network.

Speaking for an organization that includes many rural publishers, I have some expertise in the uses and efficiencies involved in small post offices. I recognize that the post office provides a certain civic pride to communities that may have little else to tie them together. This is true, particularly, in the Midwest and South where many of my company's newspapers circulate—and where shrinking agricultural communities may have lost the bank, the feed store and the gas station. But the rural post offices remain, sometimes staffed by a single person.

It is not easy to contemplate closing any of those facilities. And it may be true that their loss saves little on the Postal Service's bottom line. However, in good conscience, I have to say that I think it is time to permit the Postmaster General to decide how many post offices he needs. Public review procedures are in place. Neither Congress nor the PRC is really in a good position to make those determinations.

Establishing expected service standards for all mail classes and holding the Postal Service's feet to the fire, as the President's Commission recommends, will

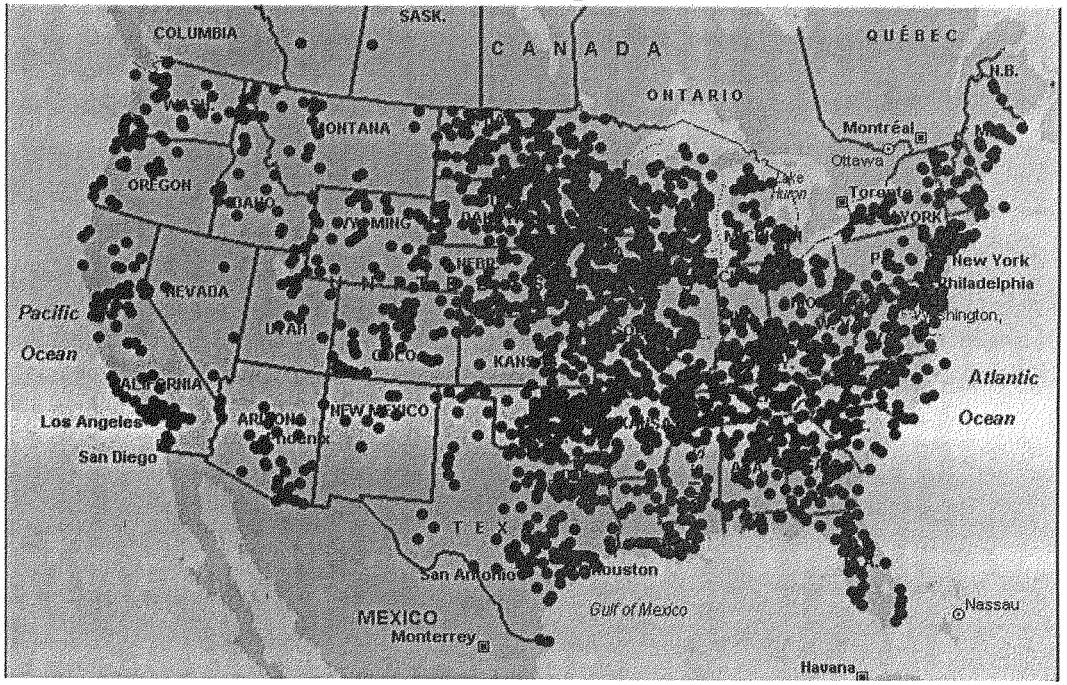
go a long way toward protecting mailers and their customers from losses of service that might result if the Postal Service goes too far. And, of course, Congress always has the ability to step in again if it believes the Postmaster General has, indeed, gone too far.

I have high regard for Postmaster General Jack Potter's management of USPS and its Transformation Plan. I believe both Congress and the mailers need to give him credit for understanding his business. We must create expectations for him—such as sound universal service, achievement of service standards, a mail mix that includes large and small mailers' products, letters, newspapers, parcels and such—and to let him manage to them. If streamlining the network, however, is done with an eye to serving only large volume, high density mailers, we will be back, asking Congress to step in to right the ship. The Postal Service must serve all of America, not just its large corporations.

We appreciate the opportunity to provide our views, as this panel contemplates the next best path to postal reform. We pledge our continued cooperation in working with you to shape legislation and to provide America with a sound Postal Service in the 21st Century.

National Newspaper Association

2004 Membership Distribution



TESTIMONY OF WILLIAM J. IHLE
SENIOR VICE PRESIDENT CORPORATE RELATIONS
BEAR CREEK CORPORATION
ON
"POSTAL REFORM: SUSTAINING THE 9 MILLION JOBS
IN THE $900 BILLION MAILING INDUSTRY"
BEFORE THE SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
MARCH 9, 2004

Chairman Collins, Members of the Committee I thank you for the invitation to appear before you today to testify on the preservation of a strong United States Postal Service. My name is Bill Ihle, and I am the Senior Vice President for Corporate Relations, Bear Creek Corporation of Medford, Oregon. My testimony today is presented on behalf of Harry & David and Jackson & Perkins, mail order companies which are a part of Bear Creek Corporation. Bear Creek is an active supporter of the Postal Service. Our Chief Executive Officer is an active member of the Direct Marketing Association; our Senior Vice President General Manager Customer Operations is Vice President of the Parcel Shippers Association; and we are active in other industry associations. Let me explain a little about both of these companies which will help the Committee understand why the Postal Service is such an indispensable part of our business, an invaluable partner, ensuring that our quality gifts grown, manufactured and assembled in Medford, Oregon, be delivered timely, reliably and affordably to homes and businesses throughout the country, including Caribou, Maine.

Bear Creek Orchards was founded in 1886. Brothers Harry and David Holmes took over the family orchard in 1914. Faced with the loss of their normal markets because of the Great Depression, they hit upon the idea of offering Christmas gifts of fruit by mail. The brothers' perseverance, ingenuity, and the extraordinary quality of their fruit secured lasting customers.

Today Harry and David is recognized as America's largest mail marketer of gourmet gift fruits, fine chocolates, baked goods, confections and home décor accessories. Harry and David is best known for its signature product, Royal Riviera® Pears, which require special climate and soil found in only a few places in the world. Medford, Oregon, our headquarters happens to be one of those places.

Innovation and bold marketing ideas have allowed us to produce many gift products such as the Fruit-of-the-Month Club® and the Tower of Treats®, to name a few. We are a gift company that has brought joy to many generations--perhaps even your parents and grandparents.

Jackson & Perkins was founded in 1872 and began selling roses before the turn of the Century. The company's entrance into the mail order business was serendipitous. At the 1939 World's Fair, the company's display of roses was such a success that visitors from all over the nation purchased those roses but did not want to carry them home. They asked the company to mail those roses instead; buyers told their friends back home of the convenience offered in receiving roses by mail. Orders began to pour in from all over the nation. Hence another mail order business was born. Bear Creek Corporation acquired Jackson & Perkins in 1966. In 1987, the Company purchased Armstrong Roses, further consolidating their presence at the retail nursery level.

Today, Jackson & Perkins is the world's largest patented rose producer. Jackson & Perkins Wholesale division includes research and hybridizing facilities in Somis, California, and a 5000-acre growing operation near Wasco, California. Two of our own roses, Medallion and Red Masterpiece, were selected for special issue postage stamps by the US Postal Service in 1978.

The Postal Service has been an invaluable partner we have come to rely on. Because we give a 100 percent satisfaction guarantee, it is imperative we have a high level of confidence in our delivery service. We have that confidence with the US Postal Service.

President Bush, the Commission that President Bush appointed, and this Committee have done great service in identifying the dangers faced by the Postal Service. As you have pointed out, Chairman Collins, a serious challenge that the Postal Service faces is a decrease in mail volume as business communications move more and more to the internet and the Service now faces what appears to be the inevitable decline of First Class Mail, a category of mail that accounted for 48 percent of total mail volume and a major revenue source to cover the Postal Service's fixed, invariable institutional costs. Also, Chairman Collins, as you have pointed out, the Postal Service is "the linchpin of a $900 billion mailing industry that employs 9 million Americans in fields as diverse as direct mailing, printing, catalog production, and paper manufacturing. The health of the Postal Service is essential to thousands of companies and the millions that they employ." We are one of

those companies, and our employees are part of those millions that are employed because of the viability of the Postal Service.

Our organization employs more than 2000 year around and 8000 additional employees during our peak season. We move millions of packages through our distribution channels each year using direct mail to market our products. We bill and communicate with our customers through First Class Mail. Our true success rests with accurate, on-time, affordable package delivery. The United States Postal Service is our primary source used for this task.

After reading the July 2003 report of the President's Commission, it is clear to us that the Postal Service's present model will not work in the future. We like a lot of the Commission's recommendations for both legislative and administrative reform and think those recommendations are a good starting point for the restructuring that Congress must undertake. It appears to us that there is considerable agreement between those recommendations and past legislative efforts of the House and Senate Committees that have been concerned with reform. In particular, we think that H.R. 4970, introduced in the house in the 107th Congress, and S.1285, introduced in 2003 agree in most important respects and seem to be consistent with many of the recommendations of the Presidential Commission. We are particularly pleased that both bills provide that the mission of the Postal Service is "the physical delivery of letters, printed matter, or *packages* weighing up to 70 pounds, including physical acceptance, collection, sorting, transportation or other services ancillary thereto." (Emphasis added) Equally important, both Bills seem to be 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.

Including these principles, we think there are fundamental principles that reform legislation should recognize, and are consonant with both the recommendations of the Presidential Commission, the

Bush Administration's criteria for reform, and the legislation proposed in the past in the House and in the Senate, and they are:

1. Continuance of universal service
2. Greater flexibility in the Postal Service's ability to fix prices and services
3. Deregulation of competitive products so that the market will govern prices and services
4. Right sizing of the Postal Service's infrastructure
5. A redefined regulatory regime to ensure that the Postal Service is performing its mission; has transparent operations and financial controls; has the power and the necessary tools to ensure that there is a fair and equitable rate structure, both for competitive and non-competitive products, and fosters competition, guarding against abuse of the Postal Service's monopoly powers
6. Adequate compensation for Postal Service employees at all levels in order to attract top people and to give them the proper incentives;
7. Removal from escrow of the "savings" from reduced retirement payments pursuant to P.L. 108-18, and the rectification of the recently imposed obligation upon the Postal Service to cover, alone among all government agencies, the military service component of its CSRS retirees' pension payments.

1. Continuation Of The Core Service Of The Postal Service.

It was a great relief to our company when the Presidential Commission determined that the Postal Service should continue as a public service and that its universal service obligation should continue. More particularly, we were gratified that the Commission reaffirmed package delivery services as a core part of the universal service mission. For more than a century, the package delivery service has been an essential and integral part of what the Postal Service does. It is hard to imagine how our companies could have grown and been successful without the Postal Service over the last century. I am comfortable in asserting that, without the Postal Service providing Parcel Post service as a core function, the $900 billion mailing industry that we know today would be vastly different. We are even more certain that our companies would not exist. Suggestions by competitors, or at least one competitor of the Postal Service, that it should not be delivering packages because there are private

sector companies which also do that, is a prescription for the piece by piece dismantling of the Postal Service and therefore its capacity to perform universal service. The interests of a single company should not override the public interest in seeing that a viable universal service with its core missions continues. Reform that does not perpetuate that core function of the Postal Service is a "reform" that we could not support because it would signal the end of the universal Postal Service that we depend on. Of particular importance to us is a six-day-a-week affordable, universal and reliable package delivery service that we have a choice to use.

2. Greater Flexibility For The Postal Service In The Establishment Of Postal Rates, Classes, And Services.

We think everybody has now recognized that the Postal Service needs to be able to respond in real time to changing market conditions and that the two or three year long cycle of changing rates and service offerings simply is incompatible with a business model that will survive in the future. Several models for this flexibility have been advanced and we are sure that this committee will fine tune those models to ensure the best outcomes. We strongly support the ability of the USPS to establish postal rates without prior approval from the regulatory body within price caps established by that body. Also, we believe that the Postal Service is well launched along the road to solidifying its private sector partnerships where the mailers perform more and more of the preparation requirements, and use technology to deliver a more automatable product to the Postal Service, and mailers themselves, in collaboration with other private sector partners, deliver their mail to the final end of the postal chain, ideally with only the delivery function to be performed. Generally, we support the performance of handling, processing, and transportation functions outside of the Postal Service when they can be performed more efficiently there. It is what private business itself does; it outsources particular functions that other specialists can do more efficiently and at less cost. At the same time, we must say we think that the Parcel Post Destination Delivery Unit service is a model of the efficient sharing of postal functions. Those rates, recognized by the Postal Rate Commission over the adamant opposition of competitors of the Postal Service, promote efficiency by combining the advantage of the lower cost of private sector private parcel processing and transportation and the Service's economy of scale in delivery. That model should be continued and encouraged.

Another flexibility for the Postal Service that we certainly endorse is the use of negotiated service agreements with particular mailers where the rates and services can be customized for that mailer with a bottom line advantage to both the Postal Service and the mailer. The fact that only one such agreement has been negotiated and approved thus far is proof in our eyes that the rules imposed, both by the Postal Service and by the regulatory body, are excessive and are discouraging innovation by mailers when deals are there for the offing.

3. The Postal Service Should Be Free To Behave Like A Regular Business In The Competition For Core Postal Products That Are Open To Competition

We firmly believe in the deregulation of postal products that are competitive, that is, for which there is competition in the marketplace. At this time, that would seem to be applicable only to Parcel Post and its Bulk Package Delivery services, Priority Mail, and Express Mail. While we advocate, as do other mailers, a greater degree of flexibility for the Postal Service to respond to the marketplace for their non-competitive postal products, we believe it is more needed in the case of these particular services for which there is substantial direct competition.

In that sense, this does make package delivery service unique among the core services of the Postal Service. But it has aspects which are not provided by its competitors: only USPS provides truly universal parcel delivery service: post office boxes, APOs, FPOs, Alaska, and Saturday delivery just to cite some examples. There are a number of public service aspects to the Postal Service's provision of service to these competitive services. USPS delivers parcels everywhere almost every day with published and uniform tariffs. It does not impose a surcharge on residential deliveries and does not compel the ordinary citizen to pay hefty overcharges to go to a franchise in order to send a package when that citizen only has one package to mail. In fact, its competitors hand over to the Postal Service for delivery packages that are inconvenient, difficult, or costly for them to deliver. USPS does not do that. They are the carrier of last resort. That is one of the reasons that such service remains a core business of the Postal Service that must be preserved so that there is competition for parcels and service for everyone.

The regulatory regime that is incorporated into reform should allow the Postal Service to optimize the value of its sunk network costs, the delivery to every home and address, by competing freely in

the non-monopoly competitive core services, particularly parcels, even thought that network may make the Postal Service more efficient than competitors for parts of that network. Naturally, we want as many competitors for our services and our business as possible, but this statement is not merely our selfish view. The President's Commission also recommended that these competitive categories, Bulk Parcel Post, Priority and Express, should be free from regulation by the regulatory body.

At the same time, we must say we understand the need for and do support a regulatory regime that will ensure that competitive products are not cross-subsidized by monopoly products of the Postal Service. In other words, we support a "level playing field." It is not in our long-term interest for any of the vendors who provide our transportation services to have an unfair advantage over another, because that will soon end in a re-centralization and a monopolization of the ability to provide that service. We think the provisions of S.R. 1285 and H.R. 4970 ensure against cross-subsidization of competitive products and that they strike the right balance between protection of users of monopoly services and unfair competition.

It is imperative for our companies to have more than one or two suppliers to support our parcel delivery needs. In 2003, Bear Creek sent several million parcels to its customers utilizing the most cost efficient and service-reliable carrier, USPS, which represents the majority of our parcels. The balance of parcels were sent via UPS, FedEx or other various carriers. A large portion of these parcels were delivered via private sector parcel processing companies, thus taking advantage of the Parcel Post Destination Delivery unit service at a more competitive price. We are utilizing the drop ship parcel rates that were approved by the Postal Rate Commission in recent years. Both of these services are positive steps in the right direction to making the Postal Service a meaningful competitor in this market.

The parcel market is highly concentrated. Parcels weighing more than one pound are 97 percent concentrated among four carriers, and the Postal Service is lagging behind at 18 percent. In the sub-market of ground parcel delivery, excluding expedited transportation shipments, there is even more market dominance with UPS having a 78 percent market share and only 7 percent for the Postal Service. This is the sub-market which is Parcel Post. UPS delivers 3.82 billion parcels and USPS only 381 million.

Obviously, if the Postal Service were to be legislatively prohibited from participating in the ground parcel shipment market, eliminating one of its core functions, UPS's share would increase even more, resulting in a virtual monopoly of the market by UPS. It is absolutely essential for our company, and for many other mail order companies that we know of, that the Postal Service be able to continue to perform its core function of delivering packages if there is to be any choice for us and other mail order companies; we cannot be left at the mercy of one dominant carrier that will dictate to us the prices, the terms and the conditions under which our packages will be delivered. And we need to emphasize the fact that that one dominant carrier is regulated by no government entity. It can do whatever it wants; charge whatever it wants; dictate whatever conditions it chooses; and there is no government agency to say "no". We would not call that a level playing field.

4. Removal Of The Escrow Of The Civil Service Retirement System (CSRS) Savings

As it has been explained to me, a mistake was made in determining how much money the Postal Service owed to the Civil service Retirement Fund – a gigantic mistake involving billions and billions of dollars – which we, as a mail user, have already overpaid into the fund. We were further told that Congress had fixed this overpayment situation in Public Law 108-18. However, it appears that the fix was only temporary, and that unless Congress approves the way in which the Postal Service is going to spend the future monies that it will not have to pay into the CSRS, money that it never in fact owed, money that we as users of the postal system should never have had to pay, that we will have to continue to pay that amount. I am sure that the members of this Committee, as close in touch as you are with constituents, will understand how puzzling this whole procedure is to the ordinary citizen. As a postal rate payer, we are told that the excess payments that we have already had to make into the Civil Service Retirement Fund will not only not be refunded to USPS, and derivatively to us in the form of lower postal rates, but that they will continue to be exacted from the Postal Service and from us in the form of higher rates, unless Congress takes some action this year. By all means, we want Congress to make sure that the Postal Service does not improvidently spend these "savings". But I hope the Committee will understand when I tell you that, as a rate payer, when the Postal Service says that they will use some of these "savings", money that we have already overpaid, to maintain lower postal rates in the future, we do not find that an improvident expenditure. Whatever else happens this year, we are sure that in fairness and equity the Congress

will take the necessary action to ensure that its constituents, those who pay the postal rates, will not have to continue to pay more than they should have in the past and in the future.

While I am on the subject, and it is an immensely complicated one, I must tell you that I also do not understand why the Postal Service alone among all government agencies has been asked to fund the military service component of its CSRS retirees' pension payments. The debt this country has to its military retirees is a national debt that should be borne by all tax payers, and not just users of the postal system in the form of higher postal rates.

5. Conclusion

On the basis of what we have heard from the Postal Service, the Presidential Commission, and the Congressional Committees looking at this matter, the Postal Service is living on borrowed time. But for the short term windfall of the CSRS fix, and the extraordinary efforts of the current Postmaster General and his staff, the Postal Service would already be in crisis. Because of the successful implementation of parts of the Transformation Plan and initiatives of the Postal Service, resulting in $2.7 billion in savings, and the windfall benefit from the CSRS fix, the Postal Service has been able to produce $5 billion in savings over the last three years, apparently without obvious degradation in service. The career employee complement has been reduced by over 80,000, a 10 percent reduction without layoffs. The most recent financial report of the Postal Service shows that expenses were constrained to a 1.7 percent increase despite expanding the delivery network, but nevertheless showing that revenue was down $181 million for the first quarter and expenses were increased to $272 million over the same period last year. Overall mail volume dropped three-tenths of a percent, while deliveries rose 1.7 million. Standard Mail increased a modest two-tenths of one percent and, of course, First Class Mail declined. On the good side, the expenses are quite a bit less than had been projected. And, productivity is up. But this is not a promising picture. Added to this, we understand that there are unfunded liabilities for the future of $92 billion.

Clearly, this is the time when action must be taken. Congress must design the new business model. We think that there are a number of designs that have been proffered by responsible sources, including the Committees. So far as we can tell, everyone who cares about the Postal Service is convinced that action must be taken now; there is fairly general consensus about what the broad

outlines of that reform should be, and we trust the Congress will not let the difficulties of providing the details of that reform, or the opposition of the few selfish competitors of the Postal Service who wish it harm, will frustrate the enactment of reform.

I thank you for your consideration and I would welcome further questions about how our companies are so dependent upon the Postal Service and our further thoughts about how reform will affect the future of our companies.

William J. Ihle, Senior Vice President Corporate Relations
Bear Creek Corporation

BEFORE THE UNITED STATES SENATE
COMMITTEE ON GOVERNMENTAL AFFAIRS

Testimony of Shelley Dreifuss,
Director of the Office of the Consumer Advocate
Postal Rate Commission
March 9, 2004

Thank you for the opportunity to testify before this distinguished Committee on Governmental Affairs regarding the recommendations of the President's Commission on the U.S. Postal Service. It is an honor and privilege to share my views with you.

Postal reform is a matter of great importance to our economy, and of vital interest to the users of postal services. This includes, of course, the many large mailers and their associations and representatives who have and will continue to regularly present their views to you; but users of postal services also include the hundreds of millions of consumer and small business mailers who depend on regular mail delivery to their residences and places of businesses. In addition, consumer and small business mailers rely on easy access to the purchase of vital postal services through retail facilities and other means. Above all else, they seek affordable and high quality postal services.

Role of the Consumer Advocate Currently and Under Postal Reform

As Director of the Office of the Consumer Advocate at the Postal Rate Commission, I am charged with representing the interests of senders and recipients of mail who otherwise would not be represented in Commission rate, classification, and complaint proceedings. While individuals and small businesses generate or receive nearly 80% of postal volume (approximately 160 billion pieces of mail in 2002), their

individual expenditures for postage and other services – on the order of $7/month – are likely to be too small a percentage of their household and business budgets either to cause them to participate individually in Postal Regulatory Board proceedings, or, alternatively, to associate as a group to represent their interests. This has certainly been the case in the three and a half decades since the Postal Reorganization Act was passed by Congress. There is every reason to believe that this condition will persist after postal legislative reform.

In enacting the Postal Reorganization Act of 1970, your predecessors had the foresight to assure participation by an "officer of the Commission who shall be required to represent the interests of the general public." The requirement for such participation eventually led the Commission to establish an office – the Office of the Consumer Advocate – to always be on the ready to protect individuals and small businesses in the conduct of regularly filed major and minor classification cases and periodically filed omnibus rate cases and complaint cases set for hearings.

On July 12, 1999, the Commission adopted a Mission Statement that clarified the role of the Office of the Consumer Advocate. According to the terms of that Statement, my office has the following responsibilities:

- Be a vigorous, responsive, effective advocate for reasonable and equitable treatment for the general public in Postal Rate Commission proceedings
- Give a strong voice to consumers, especially those whose interests are not otherwise represented in Commission proceedings
- Present evidence and arguments on behalf of consumers in Commission proceedings
- Promote fair competition between the Postal Service and its competitors for the ultimate benefit of consumers

I must emphasize that the Office of the Consumer Advocate at the Postal Rate Commission is the only entity in the nation that represents the distinct interests of consumers and small businesses before the Postal Rate Commission. In numerous proceedings before the Postal Rate Commission, the Office of the Consumer Advocate has litigated on behalf of low-volume mailers to ensure their access to benefits proposed only for high-volume mailers. I will describe two examples. In 1999, the Postal Service requested that the Postal Rate Commission issue a recommended decision for a new, low-cost Bulk Parcel Return Service. The Postal Service proposed a mailer threshold of 50,000 pieces annually. Before entering into a settlement with the Postal Service to conclude the proceeding without hearings, the Office of the Consumer Advocate convinced the Postal Service to allow mailers that were one-fifth the size of those originally targeted by the Postal Service to participate, thereby securing access to the service by the small business community.

Recently, in the Negotiated Service Agreement ("NSA") case that the Postal Service and Capital One brought before the Postal Rate Commission, at the insistence of the Office of the Consumer Advocate, the Postal Service agreed to establish a formal process allowing First-Class Mailers smaller than Capital One to negotiate NSAs along the same lines as the Capital One agreement. Without Consumer Advocate representation of small mailer interests, it is doubtful that this process would have been put in place.

The President's Commission Report contains no explicit recommendation for a statutorily required consumer/small business representative, with funds for representation provided by postal revenues. However, the current Postal

Reorganization Act does so provide, and it is my position that the Office of the Consumer Advocate (or a similar office) should be designated explicitly in postal reform legislation. I should add that the Postal Rate Commission addressed the need for consumer representation in Comments submitted to this distinguished Committee on November 19, 2003. The Commission stated that there might be sound policy reasons for ensuring a meaningful role for "captive customers," especially in those instances when the Postal Service might seek increases in captive customer rates above the rate of an inflation-based cap. As explained earlier, meaningful participation on behalf of captive customers will only be possible with a statutorily designated, postal funded consumer advocate. Of course, the role of the consumer advocate in the postal reform environment should parallel the role of the Postal Regulatory Board. In the new era, the consumer advocate should represent captive mailer interests in proceedings to increase their rates; proceedings to change or add new mail classifications; and proceedings to define postal service standards and level of performance. In addition, the consumer advocate should be given the power to file complaints about unauthorized rate increases; cross-subsidization by them of other non-captive classes of mail; and possible degradation in the quality of postal services.

The Postal Service's Mission: to Fulfill Consumer and Small Business (as Well as Large Business) Needs for Postal Services

The President's Commission recognized the importance of the Postal Service to consumers and small businesses. In Recommendation B-2, the President's Commission recommended that the mission of the Postal Service be "to provide high-quality, essential postal services to all persons and communities by the most cost-

effective and efficient means possible at affordable and, where appropriate, uniform rates." This is an excellent summary of what the Postal Service means to consumer and small business users of the Postal Service.

Traditional, Core Postal Services. The first distinct element of the President's Commission recommendation is to limit the activities of the Postal Service to core, traditional activities. These are the accepting, collecting, sorting, transporting, and delivering of letters, newspapers, magazines, advertising mail, and parcels. I am in full agreement with this limitation.

At the time of Postal Reorganization in 1970, Congress was comfortable in delegating its constitutional power to provide postal services to the nation in a form, and within the limits, known to it at that time. The Postal Service had not yet embarked on a course of competition with providers of electronic communication services in the private sector. Examples of partially electronic services that the Postal Service now claims are outside the jurisdiction of the Postal Rate Commission or *any* agency are ebill-Pay, a bill-paying service that members of the public may use to have their bills paid electronically or by mailed checks, and Netpost Card Store, a service available through the Postal Service's website that consists of greeting card purchases made by typing in the message for the card, paying by credit card, and eventually having a private company print and mail the greeting card for processing, transportation, and delivery by the U.S. Postal Service. Both of these products are in direct competition with private sector services.

GAO reports issued in the last five years indicate that the Postal Service is not an effective competitor in areas outside its traditional expertise. As a representative of

consumer interests, I do not see any benefit in having the Postal Service compete with efficient, innovative entrepreneurs in the private sector. The harm done to consumers when the Postal Service ventures into new, unfamiliar commercial activities is to force captive consumers to fund money-losing experiments that discourage efficient, innovative private companies from offering comparable services. In the absence of the distortions in the marketplace produced by a government monopolist cross-subsidizing experimental commercial ventures, the forces of competition should work to produce high quality, inexpensive, innovative products that may be purchased by individual consumers and small businesses.

The clearest evidence of my commitment to this view is the role my office played to support the efforts of a San Francisco-based organization, Consumer Action, to petition the Postal Rate Commission to clarify its jurisdiction over non-traditional services and, at the least, to establish detailed accounting and reporting rules for any non-traditional commercial activities (such as all-electronic communications products) that the Postal Service claims are not subject to the authority of the Postal Rate Commission. In response to the Consumer Action petition, the Postal Rate Commission commenced two new rulemaking proceedings: the first proposes a definition of services subject to Postal Rate Commission jurisdiction; and the second proposes the institution of new accounting and reporting requirements for non-jurisdictional products and services.

In comments on the Postal Rate Commission's proposed rulemaking to define postal services, the Association for Postal Commerce ("PostCom") wrote that the addition of the word "physical," as in *physical* delivery, acceptance, collection, sortation,

and transportation of mail would make it very plain that the Postal Service has not been given license to engage in electronic communication services. I agree that the addition of the word "physical" would be a crucial addition because it would keep the Postal Service out of marginally related and non-related commercial activities.

In the November 19 Comments submitted to this Committee by the Postal Rate Commission, the Commission stated that clarifying national policy on appropriate areas of Postal Service business would answer vexing policy questions and reduce (or eliminate) contentious Postal Rate Commission proceedings on the Postal Service's authority to enter into non-traditional commercial areas. I fully agree with the Postal Rate Commission that clear guidelines in postal reform legislation would resolve this unsettled legal question.

Just two weeks ago, a complaint was filed with the Postal Rate Commission by a small business called DigiStamp. DigiStamp has been an early provider of electronic time/date stamps for electronic files. DigiStamp is very concerned about a nearly identical, new, U.S. Postal Service product called Electronic Postmark. DigiStamp voiced understandable concerns that a $70 billion enterprise, with captive customer revenues, can compete unfairly with DigiStamp. The Postal Service claims that Electronic Postmark is outside the Commission's jurisdiction and has resisted attempts to make a full accounting for the costs of developing and operating this service. If the Postal Service is cross-subsidizing Electronic Postmark with captive customer revenues, a small startup company like DigiStamp may easily be driven out of business unfairly; and captive customers will sustain a double injury: they may be cross-subsidizing Electronic Postmark to their disadvantage as mailers, and they may be

deprived of innovative, high quality, low cost private sector services that cannot compete with a $70 billion monopoly-funded enterprise.

I agree with the President's Commission that the Postal Service should not be permitted to continue such non-traditional competitive forays in the future. The President's Commission's recommendation for resolution of the question, i.e., to limit the Postal Service to its traditional postal activities, is the best way to prevent such conflict in the future.

The President's Commission also recommends a Postal Regulatory Board complaint mechanism that would allow members of the public to file complaints with the Postal Regulatory Board on the ground that the Postal Service is engaging in activities that fall outside its core mission. In my opinion, a statutorily designated consumer representative should be among those who may file such a complaint.

Universal Service. While I would limit the Postal Service to traditional postal activities, I believe that the interests of consumers, particularly those living in non-urban regions of the United States, are best served if the Postal Service is obliged to provide delivery services and to continue to offer the sale at retail of letter, package, and ancillary special services. Rural consumers may not have ready access to the private delivery services that are more plentiful in densely populated areas. Even urban consumers may be unable to gain ready access to private delivery services. For this reason, it is important to preserve consumer and small business access to postal letter, package, and ancillary special services.

Consumers, small and large businesses, and federal, state, and local governments all need regular, timely delivery to their home and business addresses. In

view of the great need for retail and delivery services across the nation, I support the President's Commission recommendation that the Postal Service continue to be charged with a universal service obligation.

Governmental Services. The second element of the President's Commission recommendation on an appropriate mission for the Postal Service is to allow the Postal Service to engage in one additional set of limited activities: providing other governmental services when in the public interest and where the Postal Service is able to recover the appropriately allocated costs of providing such services. At the time of Postal Reorganization, Congress regularly enlisted the aid of the Post Office to furnish services to the public through postal retail facilities. The Post Office was uniquely positioned to provide such assistance. A postal historian from Oxford University, Gerald Cullinan, explains the reason for giving the Post Office (later the Postal Service) this role. In the "Nonpostal Functions" section of his historical account,[1] Cullinan states that "because of its ubiquity in American life" the Post Office "was called upon to perform a bewildering number of nonpostal functions *pro bono publico*." Also, Mr. Cullinan explains, "there has been a steady accretion of minor federal functions . . . mainly because, in many communities, the post office is the only federal office in town and the center of local activities." These included the sale of Liberty bonds and war savings certificates; registration of aliens; sale of U.S. savings bonds; sale of documentary stamps; notary public services; and accepting passport applications.

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[1] *The United States Postal Service* (1973 ed., Praeger Publishers) at pages 196 – 199.

I concur with the President's Commission's formulation of a suitable role for the Postal Service in providing governmental services to the public on behalf of other governmental agencies, and commend the President's Commission for couching this role in terms of *governmental* services. The use of "nonpostal" in the Postal Reorganization Act has produced widespread confusion and contention in the postal community, particularly since the Postal Service has used the term in a manner the legislative history indicates was never contemplated by your predecessors in 1970, i.e., to engage in a wide range of nonmail, non-traditional, nongovernmental activities that are in competition with the private sector.

The Scope of the Postal Monopoly

The President's Commission recommends maintaining the current postal monopoly over written, personal and business mail correspondence, and preserving sole Postal Service access to customer mailboxes. However, the President's Commission envisions giving the Postal Regulatory Board the duty to clarify and review periodically the scope of the monopoly and sole access to mailboxes. Most importantly, the President's Commission would transfer the power to redefine the monopoly to the Postal Regulatory Board.

Over time, the President's Commission foresees a gradual narrowing of the monopoly with a corresponding opening up for private businesses. This is a worthy goal that, in many ways, will increase access to innovative, efficient alternative service providers. I have one important concern about a shrinking monopoly, however. The President's Commission recommended a full set of interdependent recommendations.

The shrinking of the monopoly, in particular, is highly dependent on dramatic new opportunities to reduce postal costs. If the efficiencies and cost reductions predicted by the President's Commission are not realized, then I fear that a shrinking monopoly will put increasing pressure on those captive mailers who remain in the monopoly to fund the universal service obligation. In other words, as a growing amount of postal volume is no longer subject to the monopoly, the captive customer volume subject to the monopoly becomes smaller. If costs do not experience a corresponding reduction, then those fewer mailers who are still subject to the monopoly (e.g., citizens of rural communities) will have to bear a higher cost per piece. I would ask this distinguished Committee to prevent such a result.

New Approach to Setting Rates

The President's Commission recommends dramatic changes to the system of changing rates. The newly established Postal Regulatory Board would construct a framework for rate increases along new lines.

Non-competitive products. Rates for non-competitive products – identified as First-Class Mail, Standard Mail, Periodical Mail, Media Mail, Library Mail, and Bound Printed Matter – will be set initially in a baseline rate case, probably applying the current pricing criteria of the Postal Reorganization Act. In view of the fact that First-Class Mail, Media Mail, and Library Mail are all heavily used by consumers and small businesses, I ask the distinguished Committee to provide explicitly for protection of these interests by a consumer representative, possibly the Office of the Consumer Advocate.

As part of the baseline case, the Postal Regulatory Board will devise an incentive-based scheme for non-competitive rates to rise, largely at the discretion of the Postal Service. The President's Commission envisions an escalator that will be comprised of an inflation factor that will allow the rates to rise, but with a productivity deflator that will moderate the inflationary impact. The President's Commission expects that the established rate ceilings will drive postal management in the direction of controlling costs and realizing new efficiencies, both laudable objectives. In addition, current Postal Reorganization Act-style rate hearings will be supplanted by highly streamlined new procedures that will give postal management the ability to increase rates within a small fraction of the current length of time expended in an omnibus rate case.

One scenario that is not specifically considered by the President's Commission is that the incremental costs of a particular non-competitive product may rise even faster than the escalator allows. Eventually the costs of the non-competitive product may exceed its revenues, and the deficit might grow even larger over time. I recommend that provision be made for an emergency rate request by the Postal Service to the Postal Regulatory Board to increase rates to a level that would cover the costs of the non-competitive product. If this correction is not made, then other non-competitive products might be forced to cross-subsidize the deficient non-competitive product, a condition that the President's Commission has found to be uneconomic and undesirable.

From time to time, the Postal Service may find that its costs have increased above the aggregate level of revenues allowed under the non-competitive product

escalator. In such cases, the President's Commission recommends an advance review by the Postal Regulatory Board of rate increases proposed by the Postal Service. It is not clear whether such requests must be granted. Under the current Postal Reorganization Act, following a request by the Postal Service, the Postal Rate Commission must always recommend rate increases for specific mail classes to be high enough to allow the Postal Service to break even. Would this still be the case after postal reform? As before, I recommend statutorily designated representation of consumer and small business interests.

Due Process in Postal Regulatory Board Proceedings. When rate increase cases take place before the Postal Regulatory Board, it is imperative that mailers who will be subject to rate increases be accorded full due process. Under the Postal Reorganization Act, requests by the Postal Service to increase rates or add new classifications are conducted under the provisions of the Administrative Procedure Act. Although the President's Commission does not raise the matter of due process, almost certainly this distinguished Committee will want to carry over the former due process guarantees from the Postal Reorganization Act into postal reform legislation. If that is the case, it is doubtful that the sixty-day proceedings recommended by the President's Commission can furnish due process to those who will be disadvantaged by Postal Service actions.

The Administrative Procedure Act requires agencies such as the Postal Regulatory Board to give all interested litigants the opportunity for submission of documentary or oral direct evidence, rebuttal evidence, cross-examination, and the submission of arguments. Furthermore, in most cases involving postal rate increases,

the Postal Service will be in sole possession of much of the material needed to dispute the Postal Service's request. Opponents of the Postal Service's position will need sufficient time to obtain this information through discovery. Once the record has been fully developed by the litigants, and arguments have been submitted, the Commission will then need time to consider the parties' evidentiary presentations and arguments. Completion of all of these essential procedural activities will require more than the sixty days recommended by the President's Commission. Rushing through a case in sixty days is likely to result in a denial of due process.

If the Postal Regulatory Board is given strong, comprehensive powers to require the collection and reporting of financial data necessary for an evaluation of the request for additional revenues, and these data are filed regularly with the Board, it may be possible to make some reduction in the length of time for a request for rate increases above and beyond the established price cap. This truncation of the rate increase proceeding may avert a denial of due process to litigants only if the Board, and the public, are kept fully and currently informed about the Postal Service's financial position. The only reason that it may be possible to make some reduction in the length of time for Postal Regulatory Board proceedings, as compared to Postal Rate Commission proceedings, is that the public availability of relevant data should shorten the time needed both by the Postal Service to prepare requests and by mailers to evaluate them. Nevertheless, it is impossible to imagine that due process can be fully accorded litigants in sixty days. I am confident that this distinguished Committee can strike the proper balance between providing additional revenues quickly for the Postal Service while

preserving due process for those mailers who will be faced with the imposition of higher rates.

Competitive products. Competitive products would include the current postal products of Express Mail, Priority Mail, and Parcel Post. (It is unclear whether Standard Mail packages, i.e., those less than 16 ounces, would be in the competitive or noncompetitive group). Changes in the rates of competitive products should be made at the discretion of the Postal Service, according to the President's Commission. The Postal Regulatory Board, however, would be charged with ensuring that aggregate non-competitive products do not cross-subsidize competitive products and that individual non-competitive and competitive products are not being cross-subsidized by other, non-competitive products. Furthermore, competitive products should be required to make a meaningful contribution toward overhead.

A complaint mechanism would provide for the filing of complaints from members of the public on the grounds that the rate of a non-competitive product exceeds its ceiling or that a competitive product is being cross-subsidized. To protect captive customers, the complaint procedure should also be available to those who have reason to believe that particular non-competitive products are being cross-subsidized by other non-competitive products. Consistent with my earlier suggestions, I would include a statutory provision authorizing a consumer representative to lodge such complaints. In addition, I would ask that this distinguished Committee establish a timeframe for such proceedings that ensures full due process to the litigants.

Cost Allocation. The President's Commission recommends that the Postal Regulatory Board take strong measures to ensure thorough, accurate cost allocation.

One of the key tools for obtaining such information is subpoena power for the Postal Regulatory Board. Subpoenas are necessarily available only for information that the Postal Service has previously collected. Unless specific, this power may not always ensure that all of the information necessary to allocate costs appropriately will be collected. I am of the opinion that Congress should confer explicitly on the Postal Regulatory Board the power to establish rules for the collection and reporting of the type of information required to discharge the allocation duty effectively.

In addition, the President's Commission urges the Postal Service to comply voluntarily with Securities and Exchange Commission ("SEC") reporting requirements. There are two distinct virtues of such voluntary compliance: 1) SEC reporting is well understood by the public, and 2) SEC reporting allows a ready comparison between the Postal Service's financial reports and those in the private sector. However, the Postal Regulatory Board should not be limited to SEC documents to fulfill its mission. It must have authority to require periodic reporting of needed data to meet the abbreviated timelines suggested by the President's Commission.

Retained Earnings. The President's Commission recommends that the Postal Service be permitted to retain earnings up to a limit established by the Postal Regulatory Board. The President's Commission contemplates the accrual of retained earnings both from non-competitive and competitive products. The ability to retain earnings will reduce the need for management to seek emergency rate increases. Only after exhausting retained earnings could management justify an emergency rate increase.

Service Standards and Performance. Forces such as declining First-Class volumes, a narrowed monopoly, and price caps may combine to put the Postal Service in a position that makes it difficult for the Postal Service to meet established service standards. The natural tendency of any *monopoly* service provider in straitened circumstances is to allow its performance to deteriorate.

While the President's Commission recommends a mechanism for Postal Regulatory Board review of sweeping national changes in service standards, it does not propose a role for the Postal Regulatory Board to establish service standards for postal non-competitive products, require specified levels of performance, require the Postal Service to measure performance, and finally, require the Postal Service to submit the performance metrics to the Postal Regulatory Board for public dissemination. These powers should be granted the Postal Regulatory Board in order to ensure that the public has the level of postal services it needs.

I further request that a consumer representative, designated by statute, also be given a role in defining service standards to meet consumer needs. The consumer representative should be given the additional power to lodge complaints about service when the metrics show that performance has fallen below Postal Regulatory Board standards. Postal Regulatory Board powers and consumer representation are imperative to ensure high quality services by a *monopoly* provider like the Postal Service. When, by law, the Postal Service is the only entity empowered to provide personal and business correspondence services, it can risk a serious deterioration in quality of service because it can count on retaining most of its monopoly volume.

Service Standards and Performance for Noncompetitive Products. The best method for ensuring adequate service standards and high levels of performance is to give the Postal Regulatory Board the power to: (1) define and establish service standards for non-competitive products, (2) set minimum performance requirements, (3) require the Postal Service to measure its performance, (4) require the Postal Service to report the performance results to the Postal Regulatory Board, and (5) give the Postal Regulatory Board the power to initiate its own investigation of service and performance issues. These powers should be augmented by the power to subpoena any records in the possession of the Postal Service that are relevant to these measurements.

A model for the establishment of such service standards and measures may be found in the Postal Directive of the European Union. Under the directive, 85% of cross-border letter mail must be delivered in three days, and 97% must be delivered in five days.

At the present time, the Postal Service collects and reports performance information on First Class through two major data collection efforts: the Origin Destination Information System ("ODIS") and the External First Class measurement system ("EXFC"). ODIS data are filed regularly with the Postal Rate Commission under the Commission's rules. The Commission makes these data available to the public at its website. EXFC has a limited release by the Postal Service. Both of these data systems collect mail statistics chiefly on collection box mail, and the Postal Service is to be commended for doing so.

The Postal Service has elected not to collect information on much of the bulk business mail that it handles, including bulk First Class and Standard Mail, and

Periodicals. I am the recipient of weekly e-mailed reports of a planet-code tracking company called Mail Trak. Mail Trak collects the tracking information made available from Postal Service barcode readers at Processing and Distribution Center facilities through a new service called Confirm that the Postal Service offers. Purchasers of Confirm service, generally bulk First-Class Mailers and Standard Mailers, use the Mail Trak company to collect tracking information and relay it to them in a user-friendly form. Mail Trak aggregates performance information from its customers and distributes the aggregate results in a weekly newsletter. In the past year, Mail Trak reports that approximately 23% of Standard Mail letters were being delivered later than the service standard window of 7 – 10 days. This is valuable information that Mail Trak is able to provide only for its customers' mailings. The Postal Service, on the other hand, could collect and report tracking information for *all* postal Confirm customers. A Postal Regulatory Board power to require such collection and reporting could make important performance information available to the Postal Service's Standard Mail (and bulk First Class) customers.

The Postal Service does not regularly collect or report information on special services that are ancillary to the provision of non-competitive postal services like First Class. Certified Mail with Return Receipt serves as an important example. The Postal Service does not collect information on the percentage of Certified Mail pieces that actually carry the recipient's signature – the key feature of the service. In the case of Return Receipts, the Postal Service does not measure and report the average length of time for Return Receipt cards to be mailed to the recipient; and the Postal Service does not measure the percentage of such cards actually returned to recipients. These are

the essential features of the service being purchased, but the purchaser does not have a clear idea of how often the promised service is actually provided. The Postal Regulatory Board should be given the power to define the essential elements (or service standards) for each special service ancillary to non-competitive products, to require measurement of the performance of the service standard, require submission of the data collected, and to disseminate the performance results to the public.

Performance of the Universal Service Obligation. Other types of information relating to the universal service obligation should also be required of the Postal Service through the Postal Regulatory Board. Examples of this type of information are the length of time a typical mailer waits on line at a retail facility, how quickly a postal agent responds to a complaint, the number and placement of collection boxes in a community, the frequency of collection and collection times for such boxes, and the hours for access to services at postal retail facilities and alternative access in other retail businesses.

Defining service standards and minimal service performance levels should be added to the Postal Regulatory Board's powers to prevent service deterioration from becoming a recourse against declining volumes and growing pressure to reduce costs. Since the Postal Service will have a statutory monopoly on most of the noncompetitive mailpieces, the only way to ensure high quality performance is to have it regulated by the Postal Regulatory Board.

Service Quality for Competitive Products. In general, the Postal Regulatory Board will have no role in defining or monitoring quality of service for competitive products. The Postal Service is expected to compete in the marketplace on quality as well as price. However, the competitive playing field should be level with respect to

false advertising claims. The private companies with which the Postal Service will compete will be subject to Federal Trade Commission ("FTC") laws and regulations prohibiting false advertising of products. Since the Postal Service will be acting as an ordinary business (not a governmental entity) in providing competitive products, it should be subject to FTC jurisdiction and to the same laws and regulations as other businesses.

Antitrust Laws. The reasoning set forth in the preceding paragraph applies with equal force to antitrust law and regulation. Although the Postal Service will be prevented from cross-subsidizing competitive products under the President's Commission formulation, there is a broad range of anticompetitive activity that is not related to cross-subsidy that the Postal Service may be free to engage in. I respectfully ask that this distinguished Committee give serious consideration to making the Postal Service subject to antitrust laws with respect to competitive products.

Postal Insurance. This distinguished Committee may want to address separately the Postal Service's sale of insurance as a service ancillary to the sale of competitive products such as Priority Mail and Parcel Post. Insurance sales by the Postal Service's competitors will be subject to any state laws requiring shippers to provide minimal information on the nature of the insurance contract. There may be regulation by state insurance commissions of the terms and conditions of package insurance. Furthermore, courts will likely apply ordinary contract law in disputes between purchasers of insurance and the private shippers insuring their packages.

The Postal Service as a governmental entity under current laws is exempt from all of the regulations and limitations described above. In disputes between the Postal

Service and its claimants, courts have held that the Postal Service is essentially self-regulating, i.e., it writes its own regulations limiting its obligation under the insurance contract and it applies and interprets these rules when insurance purchasers submit claims. In court proceedings, the Postal Service enjoys a burden of proof standard much less onerous than its competitors. In a case involving a private shipper as defendant, the plaintiff will be required to prove his or her case by slightly more convincing evidence than that submitted by the defendant. In a case involving the Postal Service as defendant, the Postal Service's decision to deny an insurance claim will be upheld unless it is "plainly in error" or "clearly erroneous." This imposes a much higher burden of proof on plaintiffs of postal claims.

I would ask that the playing field between the Postal Service and its shipping competitors be leveled with respect to insurance and that the interests of postal insurance purchasers be protected.

Conclusion

In conclusion, I would like to give the President's Commission the highest praise for mastering a massive amount of technical material on the Postal Service's operations, cost structure, main sources of revenue, and the system of ratemaking used at the Postal Rate Commission. The recommendations made have obviously been reached after thoughtful, careful deliberation. I ask that the President's Commission recommendations be incorporated into postal reform legislation along the lines that I have suggested in my testimony. I thank the distinguished Committee for this opportunity to testify.

Statement for the Record
Michael L. Eskew
Chairman and Chief Executive Officer
UPS

United States Senate
Committee on Governmental Affairs

March 11, 2004

I appreciate the opportunity to provide you with UPS's views regarding reform of the United States Postal Service. I want to state clearly at the outset that UPS strongly supports efforts to make the Postal Service an efficient, financially sound and self-supporting part of the American landscape.

The highly competitive and efficient transportation and delivery services sector plays a critical role in enabling commerce. The Postal Service – a federal government entity – plays an important and unique role in this sector. In effect, there is a network of delivery service providers, and it is important that every component of that network, including the Postal Service, remains strong and viable.

UPS is responsible for over $230,000,000 in annual revenue for the Postal Service. We rely on the Postal Service as a primary means of communication with employees, customers, vendors, shareholders, and others. In addition, catalogues that flow through the mail often drive package volume for UPS and our competitors. We have a great deal at stake in ensuring a more efficient and viable system. A challenging aspect of the postal reform debate is to ensure the viability of the Postal Service while also ensuring that where the Postal Service competes with the private sector, it does so appropriately. This is no simple task, but we believe it can be accomplished.

We recognize the value of the work done by Congress, the Administration, and the President's Commission on the Future of the Postal Service, and we welcome this opportunity to present our views on how this might be accomplished. I would like to outline four key areas, upon which we believe, reform should focus.

First, competitive products and services should not benefit from the Postal monopoly. Steps should be taken to ensure that the Postal Service does not leverage its monopoly network to compete inappropriately with private sector companies.

Second, because the Postal Service retains a statutory monopoly, the public is best served by comprehensive and effective oversight by a strong regulator. This protects both the private sector and captive mailers from monopoly abuse. Clearly, the current process for setting rates needs to be improved, but this does not lessen the need for effective oversight. We believe these are not mutually exclusive goals.

Third, the Postal Service and the Postal Rate Commission (or new regulator established by the reform effort) should be given the tools needed to gain a clear and transparent picture of the Postal Service's cost structure. A clear and certain financial picture is paramount for every successful organization, public or private.

Fourth, the Postal Service can best be strengthened by focusing on core mail services – the delivery of First-Class Mail, Standard Mail, and Periodicals.

There is no question that postal reform is a complex and important issue. Every American is impacted in one way or another by the Postal Service. And there is little question that many things have changed since the current model of the Postal Service was established in 1970, most significantly, the development of electronic alternatives to hard-copy mail.

I am confident that Congress and the Administration, working with all affected parties, can develop legislation that puts the Postal Service on the path to financial stability and continued world-class service. In the delivery industry, we welcome competition, but only as long as there are appropriate and effective safeguards when a government-granted monopoly is present.

I will expand on each of the four key areas upon which, we believe, postal reform should focus.

1. Competitive Products Should Not Benefit From Subsidies Flowing From the Postal Service's Monopoly Network.

The Administration outlined several principles as the basis for postal reform. It called for the adoption of best practices for an enterprise of its size and scope, cost and performance measurements that are both transparent and made public in a timely manner, flexibility, accountability, and that the system pay for its own operations. The Administration also held that that Postal Service should "continue to provide affordable and reliable universal service, while limiting exposure of taxpayers and *operating appropriately in the competitive marketplace.*" (Emphasis added).

Delivery services are provided by a number of entities in the United States and there are many areas where the various parties in the delivery services sector act in concert. UPS, in addition to being a large postal customer, is working with the Postal Service in some areas. In my view, this cooperation benefits both the Postal Service and private companies, and I look forward to continuing to develop areas where the two

organizations can work together. However, ensuring that competitive products do not benefit from the postal monopoly is equally important.

The Postal Service's mail monopoly allows it to subsidize competitive products and inappropriately compete with the private sector. Revenue generated by core mail services cover nearly 92 percent of the overhead costs of the Postal Service. Competitive products cover only about 8 percent of the $26 billion in overhead costs. Private companies, must recover all infrastructure and other costs from products offered on the open, competitive market. This is a significant advantage for the Postal Service when it participates in competitive markets, and one that we would like to see addressed in any reform effort.

Additionally, the Postal Service enters competitive markets with a number of advantages due to its government status, including exemptions from a variety of taxes and exemptions from other laws that apply to its private competitors. These disparities currently go unrecognized in the postal laws. At the same time, the Postal Service has burdens and obligations under its public service mission that private companies do not face; these advantages and burdens should be identified and reconciled.

An opportunity exists to place the Postal Service's competitive products on an equal footing with those offered by private sector companies. Again, we agree with the Administration's sentiment that the Postal Service, where it competes with the private sector, should do so appropriately.

2. An Improved Rate Setting Process and More Effective Regulation are Not Mutually Exclusive Goals

Because nearly all of the Postal Service's infrastructure costs are funded by monopoly services, close supervision over the rate setting process should be maintained and enhanced. The Postal Service goes to market with both a government-granted monopoly and offers products that compete with private companies, which enables 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. This raises the question as to whether those held captive to the monopoly, whether it be single-piece First-Class mailers or a credit card company sending out millions of envelopes, are being overcharged to support competitive services. In this context, any effort to grant the Postal Service additional pricing flexibility, especially outside of a regulator, is problematic.

While the Postal Service is often compared to a private business, it remains a government entity with a public-service mission and a statutory monopoly over most of its products. This unique status requires that a strong and independent regulator exist to protect customers and competitors alike from the exercise of monopoly power.

3. Effective Cost Management and Allocation is Essential to the Long-Term Financial Health of Any Organization, Public or Private.

Sound cost management is a critical component of the financial viability of any organization, and the Postal Service – as a government entity – is no exception. Private companies operating in competitive markets rigorously track costs. At UPS and other

private enterprises, cost management, cost control and cost allocation are part of a constant, evolving process that enables organizations to deal with the challenges of a competitive marketplace effectively. Without constant attention, cost control and appropriate allocation becomes reactive and episodic, leading from one exercise in crisis management to another.

Improved cost allocation and cost management at the Postal Service will provide a solid foundation upon which to build a stable and healthy organization. The President's Commission endorsed this concept as part its recommendations stating "... the Commission recommends that the Postal Service significantly improve its cost-allocation system."

The Administration also endorsed this concept 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."

4. Focus on Core Products and 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, Standard Mail and Periodicals. These core mail services make up nearly 99 percent of the volume flowing through the Postal Service. Core mail services are the lifeblood of the Postal Service, and reform should focus the organization in this area. UPS wants to be supportive of reform efforts to this end.

Core mail services account for over 86 percent of total Postal Service revenues and 92 percent of the Postal Service's overhead. While it often is argued that additional pricing flexibility on competitive services is essential to ensure the financial health of the Postal Service, this argument ignores the fact that competitive services generate about 14 percent of total revenues and, again, account for only 8 percent of the contribution to the Postal Service's overhead. Competitive services cannot possibly solve the Postal Service's considerable challenges, even if the volume of core mail services gradually diminishes over time.

This view is supported by testimony given to the Presidential Commission by the Postal Service's Chief Financial Officer showing that extraordinarily large increases in competitive volumes would be necessary to offset very small percentage declines in monopoly products. The solution lies not in competitive products, but in the core mail services.

It also has been argued that allowing the Postal Service to expand into new lines of business and compete more aggressively in competitive markets will provide additional revenue streams and solve the Postal Service's financial challenges. Yet, according to the United States General Accounting Office, there is little evidence to suggest that non-postal products and activities have benefited the Postal Service. Additionally, this view does not take into account the dilution of management time and attention -- and valuable financial resources -- that any new or peripheral ventures require.

The Presidential Commission recommended that the Postal Service be given a focused, clear mission "to provide high-quality, <u>essential</u> postal services ..." (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 these core products.

The President's Commission worked hard to examine the challenges facing the Postal Service, and develop a vision for its future. We believe that there is an opportunity for necessary change at the Postal Service that can ensure its role in core mail services far into the future.

We commend the efforts of Committee Chairman Susan Collins and Senators Lieberman, Akaka, and Carper, and the entire Committee for its strong interest in postal reform. Additionally, I want to commend Postmaster General Jack Potter's leadership on improving the overall financial picture of Postal Service.

The Postal Service's core mail services – which consist mostly of First-Class Mail, Standard Mail, and Periodicals – play a vital role in this nation. In particular, UPS recognizes the role that the Postal Service's core mail products play in our nation's commerce, and it is important that reform enable the Postal Service to be successful in this critical mission.

This can be accomplished by legislative efforts that concentrate on reform in four key areas:

- Competitive products that stand on their own, free from subsidies flowing from a monopoly network and from governmental advantages.
- Improved rate-setting mechanism accompanied by strengthened regulatory oversight.
- Improved cost allocation, cost management, and financial transparency.

- A focus on core mail services.

The Postal Service sets the global standard for delivery of its core mail services, and UPS will assist in any way we can in ensuring that this continues. I look forward to working with this Committee, the Congress, the Administration, and the postal community on this important issue.

Hearings before the
Committee on Government Affairs
of the United States Senate
on Postal Reform
March 11, 2004

Statement of Frederick W. Smith
Chairman, President, and Chief Executive Officer
FedEx Corporation

FedEx Corporation supports modernization and transformation of the United States Postal Service. We believe that legislation along the lines set out in S. 1285 would achieve significant improvements in the Postal Reorganization Act of 1970, and we urge the committee to recommend enactment of this legislation this year. For the longer term, for reasons well described in numerous studies by the General Accounting Office and in the recent report of the President's Commission on the Postal Service, we believe 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. To this end, we urge the committee to initiate comprehensive reviews of two issues: (1) what are the pros and cons and most feasible options for transforming the Postal Service into an ordinary corporation, whether owned by the government or by private parties, and (2) what are the pros and cons and most feasible options for repealing the postal monopoly by the end of 2008.

I am today testifying on behalf of over 245,000 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. Over the last nine years, FedEx has worked closely with postal committees in the House of

Representatives in the development of postal reform legislation, and we look forward to working constructively with the Senate Government Affairs Committee in same spirit.

Since this is my first opportunity to explain our views on postal reform to this committee, my prepared statement addresses several topics presented by current postal reform proposals (in particular, S. 1285) and by the recent report of the President's Commission on the United States Postal Service. By way of introduction, however, I would first like to describe briefly how fundamentally FedEx is being transformed by changes in the market.

1. Transformation of FedEx

As many observers have pointed out, the delivery services sector is evolving rapidly. In the last several years, FedEx has been challenged by the decline of old technologies, the rise of security concerns, and the turmoil of economic dislocation. 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. Then, from June 2000 to June 2003, domestic express shipments *declined* by more than 8 percent. Overnight letter volumes fell even faster, experiencing almost three times the decline in First-Class Mail volumes 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 did not 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 beyond the familiar world of overnight express services. The FedEx family of operating companies now consists of FedEx Express, FedEx Ground, FedEx Freight, FedEx Custom Critical, FedEx Trade Networks, FedEx Supply Chain Services, and now Kinko's. 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. The portion of express revenues derived from international shipments has risen from one-quarter to one-third. In short, the FedEx that I represent today is not the same FedEx of only a few years ago.

Nor has transformation stopped at FedEx. 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. We are only just beginning to see the long term implications of the internet for modern global society.

For this reason, FedEx is constantly 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. Like the Red Queen in Alice in Wonderland, we must run very fast just to stay in one place.

2. The Fork in the Post Road

The Postal Service is buffeted by the same tides and bent by the same winds as FedEx. The national post office has been such a fixture in American life for so long that it is easy to overlook how drastically the traditional role of the Postal Service has altered in recent years. Since the earliest days of the nation, the Post Office has been considered a necessary element of the democratic experiment, in the words of George Washington, "diffusing knowledge of the laws and proceedings of the Government, which, while it contributes to the security of the people, serves also to guard them against the consequences of misrepresentation and misconception." Yet today this Senate hearing is being broadcast to the world for free across the internet. At least since the postal reforms of 1845 and 1851, the financial and operational core of the Postal Service has been carriage and delivery of letters. Yet today personal letters have mostly been replaced by telephone calls and email, and bills and statements will soon follow.

As traditional functions of the post office disappear into a technological mist, the Postal Service is becoming more and more an advertising medium that also provides home delivery of small parcels. These activities are purely commercial in nature. In each, the Postal Service faces strong competition from a host of private sector alternatives. The "business-like" Postal Service is becoming more and more a business. Over time, proliferation of high speed internet connections will put more competitive pressure on 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.

As a result Congress must choose between two long term policy options for the Postal Service. Either the Postal Service must be wound down in an orderly manner as competitors are able to take over its functions, or the Postal Service must be allowed to become a competitive enterprise with an array of products suited to the changing needs of the market.

The practical and political problems of simply closing down the Postal Service would be formidable. No matter how quickly technology and competitive alternatives advance, America will be dependent on the Postal Service for some period of time. Managing a governmental organization the size of the Postal Service through a long period of decline and diminution of function, while maintaining quality of service, would be an extremely difficult task. One needs only consider the history of Amtrak. Moreover, there is palpable unfairness in leaving hundreds of thousands of public employees stranded in dead end jobs with no chance of adapting their organization to changing circumstances. The better course, in my view, would be to give the Postal Service the tools and incentives needed to survive in a competitive world. Of course, transforming the Postal Service into a fully competitive enterprise will not protect the Postal Service and its employees against declining demand for traditional postal services, but it will give the Postal Service the best possible chance to develop new long term opportunities for its employees.

3. Transformation of the Postal Service

How can this transformation be accomplished? The most probing observer of the Postal Service in recent years has been David Walker, the Comptroller General of the United States. Mr. Walker has concluded, "*incremental steps toward postal transformation cannot resolve the*

fundamental and systemic issues associated with the Service's current business model. . . . Fundamental changes will need to be made to the Service's business model, and the legal and regulatory framework that supports it." I agree.

As presently organized and regulated, the Postal Service is ill-equipped to make the necessary changes on its own. 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 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.

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. The Commission itself acknowledged the obvious implication of its diagnosis— "some have suggested that perhaps the Postal Service can best act like a business if it is permitted to become a business"—and then promptly rejected the apparent remedy. Turning the Postal Service into a corporation—even one wholly owned by government—would be "risky," says the Commission; it might provide "destabilizing." Instead of the merely difficult, the Commission recommended the impossible: asking a government agency to emulate a "world class business."

I operate a "world class business," and it is not that simple. 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.

Thirty-five years ago, the Kappel Commission recognized explicitly the waning justification for a government owned and operated delivery company. Indeed, the main obstacle that it perceived to privatizing the Post Office in 1970, the need to arrange adequate financing, would give us but brief pause today.

> *Were the postal system being started today, it might well be operated by a privately-owned regulated corporation* not unlike the companies which operate other communication and transportation service in this country. We have concluded, however, that a transfer of the postal system to the private sector is not feasible, *largely for reasons of financing*; the Post Office should therefore continue under Government ownership. *The possibility remains of private ownership at some future time*, if such a transfer were then considered to be feasible and in the public interest.

These words were written at a time when long distance phone calls were an expensive rarity in the lives of most Americans, when private competition with the Post Office was almost nonexistent, and when not even Tom Swift had access to a global internet. In considering the future of the Postal Service thirty-five years later, we need to exercise at least as much

imagination and openmindness as members of the Kappel Commission exhibited more than a generation ago.

President Harry S. Truman once summed up the criteria for corporatization of governmental functions as follows: "Experience indicates that the corporate form of organization is peculiarly adapted to the administration of governmental programs which are (1) predominantly of a commercial character; (2) are at least potentially self-sustaining; and (3) involve a large number of business-type transactions with the public." Even today, this formula has the ring of good sense. The Postal Service would seem a prime candidate for corporatization under Harry Truman's principles.

Personally, I cannot see how the Postal Service can be transformed into a "world class business" unless it is first transformed into a business. But I recognize that this is a complex topic affecting many people, and so I am not today advocating corporatization or privatization of the Postal Service. Rather, I am urging the committee not to reject these options out of hand.

Instead, I would encourage Congress to initiate a detailed, objective, and scholarly review of the merits, demerits, and mechanics of transforming the Postal Service into an ordinary corporation, owned either by the government or by private shareholders. Such a study should carefully scrutinize both the experiences of countries that have corporatized their post offices and examples of corporatization of governmental agencies within the United States. What precisely has been gained by corporatization? What has been lost? How much will it cost? How long will it take? What are the options? In my view, such a study should be primarily fact-gathering in nature; professional scholars should be engaged to survey and organize all available information and to undertake first hand research where appropriate. So far we have too many opinions and

not enough facts. Responsibility for organizing and overseeing such a study should be delegated to a nonpolitical body such as Rand or the National Academy of Public Administration..

4. Universal Postal Service

Imbuing Postal Service management with flexibility and incentives sufficient to emulate the "best practices of the private sector" sounds good in theory, but it also raises thorny policy issues about the level of "universal service" to be assured all Americans. 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?

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.

Of course, such general observations will not suffice for many citizens. 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 stamp price for a single one-ounce letter 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 a serious 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?"

Having said this, I must also add that no pattern of universal service should be considered sacred and immutable. Before motor vehicles became available in the early 20th century, the United States had ten times as many post offices per capita as it does now. In the 1950s, the Post Office's determination to end twice-a-day delivery came within one vote of being overturned by Congress. In the 1960s, introduction of curbside mailboxes provoked fierce opposition. The present pattern of universal service is the accumulation of many small adjustments over the years. Times change, and our national approach towards universal postal service has evolved, and must continue to evolve, to meet the changing needs of the citizenry.

In this spirit, I believe it is time to reexamine the rule requiring a uniform national rate for letters insofar as it applies to bulk business mail. Current law requires the Postal Service to maintain a service for the transmission of letters that is "uniform throughout the United States." Historically, the uniform rate rule was introduced in England in 1840 as a result of a detailed

economic study that indicated the cost of transportation was an extremely small portion of total postal costs. The concept of a uniform letter rate was adopted in the United States gradually. Although Americans have become accustomed to the convenience of a uniform national postage rate for letters, it was not until 1970 that the uniform letter rate became a legal mandate. In fact, we had a non-uniform letter rate as recently as the 1940s (2 cents for local letters and 3 cents for non-local letters). Since 1970, computers have greatly increased the amount of bulk business mail and the ability of commercial mailers to sort and classify their mail. Bulk mail is today approximately half of all first class mail. Most bulk business mailers send letters to all types of addresses (urban, suburban, and rural) so a more nuanced letter rate would have no significant effect on the average postage per letter. In this area, as in other areas of postal policy, Postal Service management should be granted the maximum level of operational freedom consistent with the public interest. I therefore urge the committee to consider authorizing the Postal Service to propose bulk letter mail rates to the Postal Rate Commission exempt from the uniform letter rate requirement. We will rely upon the Postal Rate Commission to ensure that any new rates fairly reflect Postal Service costs, and that revenue from non-competitive areas are not used to subsidize competitive products.

5. A Business-Like Back Office

Universal collection and delivery service are the public face of the Postal Service. While it is necessary and desirable for Congress and the regulator to assure that universal postal service meets the needs of the nation, I believe it is helpful to distinguish between the "front office" and the "back office" of the Postal Service. Functions like sorting and transportation are essentially back office activities that will be most efficiently performed if they are left up to the judgment of professional managers.

Back office efficiency at the Postal Service is in the interest of virtually everyone. The Presidential Commission endorsed a "smaller, stronger, new postal network." To facilitate more efficient network operations, it proposed establishment of a special Postal Network Operations Committee (P-NOC) composed of political appointees. The P-NOC would oversee the restructuring of the Postal Service's processing and transportation systems. The purpose of the Commission's recommendation is right on target: to insulate the Postal Service's back office from political interference as it seeks to realign outdated networks. Such a committee, however, departs very far from what I would consider the ideal: that is, giving the Postal Service the same management flexibility and incentives that are available to a private company. A politically appointed FedEx-NOC would have been about the last thing we needed at FedEx during the transformation of the last three years.

Therefore, I would like to propose consideration of an alternative approach: authorize the Secretary of the Treasury to establish, with the agreement of the Postal Service, a performance-based government corporation to handle back office functions of the Postal Service. At the Postal Service, mail transportation is primarily a logistical activity with almost all of the actual transportation and some of the sorting purchased from private companies. Indeed, from a business standpoint, it would be perfectly feasible for the Postal Service, like other large companies, to subcontract transportation management to a private logistics company. To do so, however, would cast aside a great deal of accumulated expertise within Postal Service management. Why not consider a half way step and transform the network transportation unit of the Postal Service into a separate corporation working solely for the Postal Service? To achieve the efficiencies of a private sector company, this corporation should be granted the freedoms of a private company, including relief from arcane procurement and contracting regulations. To

manage this corporation, the Secretary could appoint a board consisting of both existing governors and officers of the Postal Service and outsiders experienced in the management of large scale logistics systems. Limiting the activities of this corporation to selling services to the Postal Service will obviate questions of unfair competition. The lodestar of this corporation should be the provision of efficient services to the Postal Service. Congress might want to insist that the corporation consult with local authorities before closing large facilities, although any private company should do the same without legal requirement. In short, I would suggest that you consider putting the back office of the Postal Service on a truly "business-like" basis even while continuing to regulate the front office to ensure provision of universal service.

6. Curse of the Postal Monopoly

The postal monopoly law lingers like an ancient curse on Middle Earth. The postal monopoly was originally granted by Congress to help the Post Office establish a national postal system that would enlighten and civilize the far reaches of the new democracy. Over the centuries, however, an evil wizard has seemingly taken control of the postal monopoly and distorted its application way beyond its original purpose. Today the postal monopoly, far from empowering the Postal Service, serves to enervate and demoralize good men and women while isolating the institution from the world of normal commerce behind a high hedge of tangled regulatory briars. If the hobbits can save Middle Earth (and win most of the Oscars in the process), surely Congress can break the spell of the postal monopoly.

The persistence of the postal monopoly is due mostly to an illusion that it is necessary to sustain universal service. It is often said the postal monopoly allows the Postal Service to raise extra money on cheap urban deliveries and subsidize the high costs of mail delivery in rural areas. In fact, economic studies show that the cost of rural postal service is not much greater than

the cost of urban postal service. There is no reason to suppose that the Postal Service would abandon rural areas or raise prices sharply without a postal monopoly.

Then, too, it has been argued that the monopoly protects the Postal Service by allowing it to get every last piece of mail and thus spread the fixed costs of its network over the maximum amount of mail. This logic would support extension of the Postal Service's monopoly into any business activity in which incremental costs are less than total costs. For example, granting the Postal Service a monopoly over air freight services could, by this reasoning, reduce the price of a first class stamp by several cents. What's wrong with this logic? What is wrong is that a monopoly not only generates economies of scale, it also breeds inflated costs, inefficiency, and lack of innovation. No one in his right mind would suggest that the United States would have better or cheaper or more universal express service today if the Postal Service had succeeded in extending its monopoly to include express services in the 1970s. As studies by economists at the Postal Rate Commission demonstrate, inefficiencies due to the postal monopoly exceed economies of scale by several billions of dollars. While reasonable persons can dispute the exact figures, no one can deny that a postal monopoly implies huge costs as well as benefits.

The truth is that we have universal postal service in the United States in spite of the postal monopoly not because of it.

Current legislative proposals like S. 1285 would make two important reforms in the postal monopoly. First, a ceiling would be fixed on the scope of the postal monopoly. Under this provision, a letter could be transmitted outside the mail if the sender pays the carrier at least six times the basic stamp price. In addition, a letter weighing more than 12.5 ounces (I would suggest a more user-friendly figure like 12 ounces) could be carried out of the mail even if priced less than six times the stamp price. Second, the Postal Service would be divested of authority to

issue regulations defining the scope of the postal monopoly. This latter reform is absolutely necessary; as the Presidential Commission said, "it is a fundamental premise of American justice that the law should be administered by persons without a financial interest in the outcome."

While supporting these amendments to the postal monopoly law, I would recommend some fine tuning. For example, S. 1285 implies that bulk outward international mail should be considered outside the postal monopoly because such mail is placed in the competitive category. Nonetheless, no provision actually permits private carriage of outbound international mail, and there should be one that does so. Grandfathering current administrative suspensions of the postal monopoly is a good idea, but in many cases the precise legal results of this provision will be unclear. Hence, it would be desirable to authorize the Postal Rate Commission to issue implementing regulations. Moreover, I urge Congress to treat the postal monopoly in the future as a technical rather than a political issue. The basic principle should be that the postal monopoly should be no more extensive than necessary to finance universal service. This is an economic question amenable to proceedings before the Postal Rate Commission. When the Commission concludes that the monopoly can be pruned slightly without affecting universal service, it should be authorized to do so.

More fundamentally, we need to face the ultimate fact that the postal monopoly is rendering the Postal Service unfit to compete and prosper in the delivery services sector of the future. While the ceiling on the postal monopoly proposed in S. 1285 is similar to that adopted in the European Union in 1997, the EU has already moved on to adopt tighter restrictions. Meanwhile, several individual countries in and out of the EU have abolished the postal monopoly altogether. In all cases, reduction or repeal of the postal monopoly has meant not the

end of universal postal service but the improvement of universal postal service. Nor has any incumbent national post office suffered the loss of significant share so far.

Like these other nations, we need to gather all of the facts necessary to plan an appropriate phase out of the postal monopoly. This would be the single most important step that could be taken towards structural transformation and modernization of the Postal Service. The transition period must be long enough to give the Postal Service time to prepare for increased competition, but short enough so that it cannot afford to put off the start of those preparations. Right now, the European Union is on track to terminate the postal monopolies in Europe at the end of 2008 (although this date still needs to be finally confirmed by the EU). The U.S. must consider carefully the potential negative consequences of delaying repeal on the U.S. postal monopoly beyond this date.

Therefore, I believe that Congress should begin now to develop a quantitative study that estimates as well as humanly possible the consequences of different paths towards termination of the postal monopoly. Again, I would urge the committee to vest supervisory authority over this inquiry in a respected and nonpolitical organization.

7. A Level Playing Field

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 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. What Representative John McHugh has dubbed the "firewalls" in his postal reform bill remain crucial to our support for any postal modernization legislation.

By way of emphasis, let me highlight some of these provisions of particular concern to FedEx:

- reliance upon objective factual criteria (degree of effective competition), administered by an independent regulator, to define noncompetitive and competitive categories;
- separation of Postal Service accounts, both operating accounts and capital assets, into competition and non-competitive categories;
- requirement of a reasonable allocation of common overhead costs to competitive products;
- an end to key legal privileges (such as exemption from the antitrust laws) favoring the Postal Service in the provision of competitive products; and
- collection of an assumed federal income tax on revenue from competitive postal products.

Without strong firewalls, postal reform is a dead letter. Mailers will not accept greater commercial freedom for the Postal Service if they will be forced to underwrite the Postal Service's competitive adventures. Competitors—including not only companies like FedEx but also newspapers, messenger companies, and private post offices—will oppose any bill unless assured that the Postal Service's competitive activities will not derive substantial financial, legal, or commercial benefits from its noncompetitive activities. Just as important, reform will fail as a modernization measure if the Postal Service is not required to operate at least some portion of its business with true private sector efficiency. Subsidized Postal Service participation into competitive markets will not raise the Postal Service's operations to the level of private

enterprise; it will bring down the competitive market to the false economies of government monopoly.

8. Access to Mailboxes

Under current law, private companies are prohibited from placing items in curbside mailboxes even though a study by the General Accounting Office has found that a clear majority of Americans (58 percent) believe this restriction should not apply to reputable delivery services like FedEx. This rule was adopted during the Depression, apparently to prevent hard pressed utility companies from using messenger companies to deliver bills. No public purpose is served by this rule. No one has ever suggested, for example, that universal postal service requires restrictions on the right to deposit documents and parcels in private mailboxes. No other country restricts access to private mailboxes (obviously theft from private mailboxes is a different matter which must continue to be proscribed).

The economic importance of the mailbox access rule has escalated enormously since it was originally adopted. In the mid-1960s, the Post Office announced it would henceforth deliver only to curbside boxes in new residential areas, citing studies showing that curbside delivery was half as expensive as delivery to the door. Today, more than 70 percent of residential deliveries are made to curbside mailboxes, cluster boxes, apartment boxes, and similar Postal Service-only receptacles.

The nation's system of mailboxes was built and paid for by householders. The mailbox network provides a uniquely simple and inexpensive means for delivering letters and small parcels to America. There is no moral or economic reason why access to this network of mailboxes should be reserved for the exclusive use of the Postal Service.

I therefore encourage the committee to consider rolling back the Postal Service's exclusive access to private mailboxes under controlled conditions that will prevent any disruption in the market and protect the rights of householders. The end result of this reform will be to make the nation's delivery services sector more efficient by extending the efficiencies of the national mailbox system to private delivery services.

9. International Postal Policy

Current legislative proposals would also vest authority for international postal policy in the Department of State and set pro-competitive objectives for the Department of State to pursue. International mail would be regulated in the same manner as domestic mail. Rate and classification provisions of international agreements would be subject to review by the Postal Rate Commission. Customs provisions would be applied more equally to post offices and private companies. I strongly support all of these reforms, although I believe that it would be helpful to add to the list of objectives an explicit reference to the goal of bringing international postal agreements into compliance with the General Agreement on Trade in Services (GATS) by a date certain.

In addition, I urge the committee to include in any legislation two simple, but basic, bottom line rules to guide U.S. international postal relations. First, it should be made clear the United States government and its courts will not be legally bound by measures adopted by officials of foreign post offices. Post offices in most countries are today essentially commercial actors, seeking to win customers and earn revenues. In recent congresses, the Universal Postal Union has delegated authority to adopt rules defining aspects of international postal operations to a committee of postal officials, the Postal Operations Council. Such rules can affect the rights of U.S. mailers and private express companies (e.g., through measures affecting how much post

offices pay each other for delivery of mail, where international mail can be posted and by whom, and how customs laws affect postal parcels). While the United States may wish to commit itself in advance to rules adopted by a council of foreign governmental officials like the UPU's Council of Administration extending this deference to a council of postal officials is wholly inappropriate.

Second, the Postal Rate Commission's annual reports on international mail have demonstrated that the Postal Service is charging substantially less for the delivery of foreign mail than it charges for delivery of equivalent American mail. This is patently absurd. There is no legitimate reason why a person living in France or Japan or India or Singapore should pay any less for Postal Service delivery of a letter than a person living in New York or Miami or Los Angeles or Honolulu. Of course, no one can object to a special program to assist persons in the poorest countries in exchanging personal correspondence with friends and relatives in the U.S., but most international letters, especially those received from industrialized countries, should be charged at the same rate as domestic letters.

10. A Modern System of Price Regulation

Current legislative proposals would strengthen the Postal Rate Commission substantially and rechristen it the Postal Regulatory Commission. FedEx strongly supports these reforms.

Under these bills, new procedures for rate regulation would be developed by the Postal Regulatory Commission in accordance with general principles set out in the legislation. While details of the new regulatory schemes are unknown, it is clear that the bill intends the Commission to distinguish between products offered in markets dominated by the Postal Service and products offered in competitive markets. The intent is to give the Postal Service substantially

more freedom in the pricing of competitive products and at least some greater flexibility in pricing noncompetitive products.

At the same time, these bills would introduce new safeguards against unfair competition by the Postal Service in competitive markets. For the first time, subsidization of competitive products by market-dominant products is expressly forbidden and a reasonable allocation of institutional costs to competitive products is expressly required. The Postal Regulatory Commission, armed with subpoena power, is given new authority to review rates annually, to require illegal rates be raised to legal levels, and to impose other penalties on the Postal Service. In addition, the Postal Regulatory Commission gains jurisdiction over international rates, a conspicuous oversight in the 1970 Act. Most fundamentally, the Postal Service is required to divide its costs, revenues, and assets between market-dominant and competitive products. While no system of rate regulation is perfect, these reforms represent a substantial improvement over current regulatory controls.

FedEx believes that the new system of postal rate regulation envisioned in these bills is reasonable, well-considered, and fair-minded.

SUMMARY

The delivery services sector is undergoing fundamental changes as the implications of the Information Revolution are manifested in national and global markets. In response, FedEx has in the last few years transformed itself from a company focused on U.S. express services into a family of companies providing supply chains stretching around the world. These same technological and economic trends also imply profound consequences for the future of the Postal Service. In the foreseeable future, physical carriage of letters will diminish substantially, and the Postal Service will lose the revenue stream that has sustained it for two centuries.

If the Postal Service is to survive and prosper in coming decades, it must be granted the management tools and be exposed to the commercial incentives that allow a company like FedEx to respond to changing circumstance. The suggestion that a government agency with a legal monopoly can emulate a "world class business" does not ring true. In my view, serious and systematic attention needs to be devoted to the possibilities of transforming the Postal Service into a corporation and phasing out the postal monopoly by the end of 2008. While final resolution of these basic issues stretches beyond the bounds of the present legislative proposals, the time for beginning sober analysis is at hand.

In respect to current legislative proposals, FedEx urges adoption of legislation along the lines set out in S. 1285. However, we would strongly urge the committee to consider the merits of the following additions or amendments:

- exempt bulk business mail from the law requiring the Postal Service to maintain a uniform national rate for letters, while maintaining Postal Rate Commission oversight of any new bulk business rates;
- authorize Treasury to create a government-owned corporation that would provide transportation and sorting services to the Postal Service on a truly business-like basis;
- clarify certain aspects of the postal monopoly provisions in the bill;
- authorize the Postal Rate Commission to phase in private delivery services access to mailboxes; and
- bring international postal agreements into compliance with GATS by a date certain and adopt guidelines for U.S. international policy that make clear (1) that the United States will not be bound by rules adopted by a committee of

foreign postal officials such as the UPU's Postal Operations Council; and (2) that Postal Service is not authorized to deliver foreign mail more cheaply than American mail except in cases of particular humanitarian need.

Thank you for your consideration of the views of FedEx Corporation.

TESTIMONY OF

Gary M. Mulloy
Chairman and Chief Executive Officer
ADVO, Inc.

To the

Senate Governmental Affairs Committee

March 11, 2004

Madam Chairman, Sen. Lieberman, 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. Each year our company pays approximately $500 million in postage, about half our gross revenues. I am pleased to represent the 3,700 ADVO associates that service over 20,000 small and large businesses. Headquartered in Windsor, Connecticut, we are the proud constituent of the Committee's ranking member. We also have facilities in Senator Voinovich's state of Ohio, Senator Specter's state of Pennsylvania, Senator Bennett's state of Utah, Senator Levin's state of Michigan, and of course Senator Carper's state of Delaware. I would particularly like to thank Chairman Collins and Senator Lieberman and the entire committee for your work on Public Law 108-18 which attempted to address the Postal Service's CSRS funding issue. One of the key events that led to that

effort was a request by Senator Lieberman for a report from GAO. I thank the Senator for his initiative and for the commitment of every member of this committee to see that the CSRS funding is corrected.

As a result of Public Law 108-18, the Postal Service has promised to hold rates steady until at least 2006. Following three rate increases in 18 months, this respite came at a critical juncture for the Postal Service, our industry and the economy as it prevented another rate increase and created a window of opportunity for this Committee and Congress to thoughtfully consider postal reform.

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In the letter I received from the Chairman and Ranking Member, I was invited to address the wide array of reform proposals being considered by this committee. In response, I have submitted written testimony for the record on a variety of postal reform issues. Today, I will focus my remarks on a topic that isn't always considered exciting: accounting. If this Committee and the Congress would address in a comprehensive manner the issues regarding the accounting for funding of retirement and health benefits of postal employees, you will put the Postal Service on a truly transparent, more clearly understood financial footing so that the other reforms can succeed. In addition, proper accounting of these benefits will allow the Postal Service to keep its commitment to its employees and retirees: all pension and health benefits can be paid, now and in the future, *and* the Postal Service will be able to offers its customers an extended period of rate stability that will allow all of us to take advantage of the now-recovering economy to grow volume and revenue for the Postal Service and improve the financial health not only of the USPS but our industry and the overall economy.

As one of the Postal Service's largest customers, I can confirm GAO's death spiral prediction that increasing rates will continue to drive business, volume and revenue away. Non-competitive pricing that creates higher than necessary postal rates 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 rates which in some cases are now nearly twice that of a private delivery system. If postal prices were established, maintained, and managed in a more market-oriented, efficiently run system, private industry would use the USPS more, and both the Postal Service and industry would experience significant growth.

ADVO's current strategy is to double our business in the next few years. This will be done both by expanding the geographic reach of our program by going to more households and by increasing the frequency of our programs where they exist today. This expansion *could* bring significant additional business and revenue to the Postal Service. However, we have already begun shifting a portion of our current volume to alternate delivery. In just the three markets where we currently rely on our own private carrier delivery system, we are delivering mail pieces that have more advertising, are heavier, with equal readership and response to mail and are achieving a savings of over $6 million per year compared to the cost of using the Postal Service. Unless changes are made, much of our future growth will be outside the Postal Service and we will continue to look to shift existing volume to other alternatives.

Now let me give you a glimpse of a different scenario. Extending the current period of rate stability beyond 2006 will allow us to be even more aggressive in our expansion plans, because we would have confidence that our largest cost will be contained. We have the latent ability to create three (3) billion more mail pieces. Importantly, we would be able to plan to grow our business in partnership with the USPS. Others in our industry would respond in similar ways. Continued rate stability would benefit the mailing industry, the Postal Service and the economy as a whole. This is no overstatement. The volume generated by this hiatus in rate increases, coupled with the impact of the important reforms this committee is considering, would set the Postal Service on a positive course for the next generation. On the other hand, frequent excessive rate increases, such as the three (3) rate increases that occurred in the eighteen months from January 2001 to June 2002, will decrease business and lead to GAO's death spiral where higher rates cause volume declines leading to even higher rates which drive even more business away. Rate stability will allow the $900 billion, 9 million-employee industry to reinvest in itself and create more volume and jobs for the U.S. economy.

Stable rates coupled with comprehensive reform are not a pipe dream. This committee can lead the Congress to make them a reality. Since 1971 the Postal Service has been required 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 of funding postal operations. 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 whose effects were unknown by this Committee and Congress that are not in the long term best interests of the Postal Service, its customers, or the economy. Important information has come to light since the passage of Public Law 108-18 that requires Congressional action.

In implementing last year's action to correct the CSRS over-funding, the Office of Personnel Management made a very material accounting change to the existing 33 year methodology that substantially re-allocated to the Postal Service some of the government's responsibility for its share of the 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. Using that methodology, the Postal Service has as of today, even with last year's legislative changes, actually over-funded its CSRS liability by $81 billion. However, that fact was masked when OPM (after discovering this overfunding thanks to Senator Lieberman's GAO request) responded by quietly adopting a new allocation method that shifted much of the pre-1971 obligation to the Postal Service, to the detriment of postal customers. Instead of an $81 billion overfunding, the USPS was told that the pension obligation was still underfunded by $4.8 billion.

Interestingly, Congressional language in Public Law 108-18 established a method by which the USPS could appeal the change of pre-1971 allocation to the CSRS Board of Actuaries. The USPS has filed that appeal. They make the case that the original allocation method used for 32 years was fair and was recently determined to be consistent with sound, common practice in both the public and private sectors by the Hay Group, a well-respected actuarial firm commissioned by the Postal Service. The USPS has a sound and well-substantiated case. However, the three member, OPM-appointed Board has not heard an appeal in its 84 years of existence. It is unclear what timeline or method will be applied to the USPS appeal. You have the opportunity to take control of the appeal outcome and codify the former methodology in legislation, acknowledge that postal customers have been grossly overcharged over the years, and make the operating

and financial performance of the Postal Service clear and transparent as a productive base from which to implement other areas of reform going forward.

In addition, part of last year's legislative fix of CSRS was a new requirement that the Postal Service pay military, Peace Corps and other government retiree benefits. This transferred $28 billion in new obligations from the federal government to ratepayers. Singling out postal ratepayers to cover an obligation that benefits all taxpayers is unfair. The Presidential Commission recommended removing responsibility for military pensions from Postal Service customers. It should be immediately acted upon by this body.

This Committee can put the Postal Service on the road to financial health. If you

1. fix the problem of the allocation of benefits earned before 1971
2. transfer the military benefits back to Treasury and
3. release a portion of the identified overpayments from the escrow created last year.

If you do this, the Postal Service will be able to

1. prefund health care and
2. eliminate all the Postal Service's debt to the Treasury.
3. It will have funds for needed capital expenditures. And it can
4. provide three more years of rate stability to repay a part of the past unnecessary rate increases to all users of the Postal Service, consumers and businesses alike.

I believe that this settlement is fair to consumers, mailers, the USPS and postal workers. It removes uncertainty and offsets further volume erosion, providing time for the USPS to implement other much needed reforms that we trust the Congress will enact. Importantly, it will provide assurance to the Postal Service's employees and retirees that the benefits that they have earned and to which they are rightly entitled are safe and secure and will hopefully reduce some of the anxiety they feel about the prospects for postal reform. If the financial picture is secured, we will be in a position to bring MORE business, volume, and revenue to the Postal Service, which means more work for Postal employees.

The Congress and the Postal Service are truly at a crossroads. We all have an opportunity in this legislation to clean up the books. By eliminating the unfunded liabilities and providing for a period of rate stability, the USPS will have the volume and time it needs to transform into the businesslike model that all of us, including the President's Commission believe will allow it to continue as a viable and invaluable component of our nation's economy.

Thank you for your attention and I will be glad to answer any questions that the Committee may have.

Written Statement

of

Gary B. Pruitt
Chairman, President & Chief Executive Officer
The McClatchy Company

on behalf of

The Newspaper Association of America

before the

United States Senate
Committee on Governmental Affairs

March 11, 2004

Introduction

Chairman Collins, Ranking Member Lieberman and members of the Committee:

My name is Gary Pruitt and I am Chairman, President, and CEO of The McClatchy Company. Headquartered in Sacramento, CA, McClatchy owns and publishes 30 newspapers in four areas of the country—Minnesota, California, the Carolinas and the Northwest (Alaska and Washington). These newspapers range from large dailies serving metropolitan areas to non-daily newspapers serving small communities.

I appear before the Senate Committee on Governmental Affairs as a member of the Newspaper Association of America's (NAA) Board of Directors and as Chairman of the NAA Postal Affairs Committee. NAA is a national trade association headquartered in Vienna, Virginia, that represents 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.

I appreciate the opportunity that the Committee has given me to share the views of the newspaper industry on the important issue of reforming the United States Postal Service. As customers with a long history with the Postal Service, newspapers want and need a healthy and vibrant postal system for generations to come.

NAA looks forward to working with this Committee, the Postal Service and other mailers on a postal reform bill that assures a first rate postal service for all Americans.

While my testimony will specifically address postal "pricing flexibility," I think it is important to take a moment to summarize here the newspaper industry's position on other postal reform issues. In fact, NAA supports many of the recommendations outlined

by the bipartisan Presidential Commission, which we encourage the Committee to consider carefully as it takes a fresh and comprehensive approach toward postal reform.

Specifically:

- NAA supports the Presidential Commission recommendation to re-affirm the U.S. Postal Service as a public service with a mission of providing universal mail delivery in a cost-effective manner.

- NAA supports the Presidential Commission recommendation to create a Postal Regulatory Board—with strengthened regulatory tools—to protect the public interest and ensure the Postal Service is completely accountable and transparent in its finances and operations.

- NAA supports the Presidential Commission recommendation that the new Postal Regulatory Board should have the authority to "ensure that the Postal Service is appropriately allocating its costs across its competitive and non-competitive products and services."

- NAA believes, as did the Presidential Commission, that the Postal Service should have the operational flexibility to cut large categories of costs. This includes the flexibility to close, consolidate or relocate postal distribution and processing facilities. However, as local mailers in every community, we recognize the unique value and community contributions of small rural post offices that purely economic considerations may overlook.

- While newspapers applaud the hard work and dedicated public service of postal employees, NAA also agrees with the Presidential Commission that the Postal Service cannot realistically be expected to make long-lasting cost reductions unless workforce issues are examined. We encourage the Congress, the Postal Service and the postal employee organizations to work together on constructive, but reasonable, reform measures on workforce issues.

- NAA supports the Presidential Commission's recommendation for the repeal of the requirement that the Postal Service contribute its overpayments from the Civil Service Retirement System into an escrow account. NAA also supports placing the responsibility for funding pension benefits relating to military service of Postal Service retirees on the Treasury Department, as is the case with other federal government agencies.

With respect to pricing issues, NAA supports responsible reforms to the ratesetting process that can expedite and streamline the process of changing postal rates. However,

we also recognize that the Postal Service's governmental and public service role precludes it from having the same pricing freedoms as private companies. In particular:

- NAA supports reforms to make changing rates less burdensome and more predictable.
- Essential to such reforms are improved cost attribution and allocation procedures, which include having an independent regulator decide cost issues in a separate proceeding, not in a rate case.
- Rate flexibility within an index deserves exploration by an experienced postal regulatory board. Such a system may be workable so long as rates cover appropriately measured and allocated costs and the Postal Service cannot selectively favor some mailers to the detriment of others.
- NAA strongly recommends that, upon a reasonable complaint, an independent regulator should review rate changes before implementation to ensure that mailers are protected from flawed or discriminatory rates. Review before implementation should not delay reasonable rate changes because, from a practical matter, the Postal Service must give advance notice of rate changes to its several hundred million customers.
- NAA supports arrangements by which mailers able to perform some functions cost-effectively can earn worksharing discounts for doing so, so long as the costs avoided by the Postal Service are properly identified and measured, the discounts reflect only those cost differences, and the discounts are made available to all mailers that perform such activities.
- NAA is opposed to allowing a government service to offer special rates for individual mailers in the form of "negotiated service agreements" that are not available to other, especially competing, mailers.

Newspapers and the Postal Service

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, we spend well over $700 million on all classes of mail. NAA members depend upon the Postal Service each day for the delivery of newspapers and advertising mail products that we send to the homes of those who do not subscribe to our newspapers. 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 speaking, 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.

For you to understand our perspective, I want to take a moment to highlight here that newspapers (while mailers ourselves) compete with direct mailers (principally "saturation" mailers) for both types of advertising, but particularly for pre-printed inserts. Unfortunately, over the years this competition with other mailers has served as a source of considerable friction between newspapers and the Postal Service. Newspapers do not

believe that the Postal Service —an agency of the federal government—should take sides in the marketplace competition between newspapers and other advertising media. Regrettably, experience has led newspapers to believe that the Postal Service has in fact done so by inappropriately choosing to favor our advertising competitors through pricing strategies and new initiatives targeting the advertising revenues upon which we depend to support the news and editorial content of our 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. Just 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. And the Postal Service has repeatedly advanced pricing proposals in rate cases that would target newspaper advertising, even to the extent of proposing rate reductions for saturation advertising mail with which we compete while raising rates across the board.

In recent years, public statements by the Postal Service have also continued to advance the misperception that it is in the direct mail and advertising business. An example was its description, in its 2002 Transformation Plan, of saturation advertising mail as "low hanging fruit" that the Postal Service might seek to increase, needless to say at our expense.

While historically we have been concerned that the Postal Service is inappropriately choosing sides in the competition over advertising, we are hopeful that USPS management, under the leadership of Postmaster General Potter, has refocused the

Postal Service on its core service of mail delivery. We specifically applaud General Potter for halting e-commerce and other non-postal services that were outside the scope of its public service mission.

Pricing Flexibility

As Congress examines proposals for providing the Postal Service with "pricing flexibility," it is important to remember that the Postal Service is far from an ordinary business. It is an enormous governmental entity with great economic clout, stemming from its nearly $70 billion in annual revenues and unique privileges, including a legal monopoly over the great majority of its revenues and exemptions from taxes and most federal, state and local regulations. With this unique size and privilege come responsibilities, including limitations on the flexibility with which the Postal Service prices its services. For good reason the Congress has never granted the Postal Service both a legal monopoly and pricing freedoms.

In this regard, Congress should take pleas for "pricing flexibility" with a healthy grain of salt. In all too many instances, these pleas are simply euphemisms by large, influential mailers who believe that pricing flexibility will directly benefit themselves through lower rates. As Mr. Burruss of the American Postal Workers Union recently testified, it is important that the Committee "distinguish between the public interest in universal mail service at uniform rates, and the interests of major mailers in maximizing their profits."

Accordingly, we are more cautious towards giving the Postal Service more pricing freedom. As a public service provided by the federal government, the Postal Service simply should not have the same pricing freedom as a private company. We agree with the Presidential Commission that with pricing flexibility must come enhanced oversight to ensure that the Postal Service operates properly as a public service.

Newspapers agree that the current ratemaking process can be too lengthy, too litigious, and too expensive. NAA supports efforts to improve and streamline the process, so that rate increases are more predictable. Specifically, important outcomes of a revised ratemaking regimen should include the principles: (1) that all mailers pay rates that cover their costs, thereby preventing cross-subsidies; (2) that those costs are correctly measured; and (3) that discounts reflect cost differences.

Giving the regulator more tools that will help measure and allocate costs should expedite the process dramatically. NAA also favors retaining prior review of rate changes by a regulator before rate implementation as an essential protection for mailers and competition. Prior review before implementation would not delay reasonable rate changes because the Postal Service must always give advance notice of rate changes to its several hundred million customers.

Measuring and Allocating Costs

Cost measurement and allocation are prerequisites to proper ratesetting. Setting prices without appropriately measuring and allocating costs across products or services flies in the face of sound economic principles. I know of no private business that sets prices without a firm understanding of its costs surely nothing less should be expected of the Postal Service.

The Postal Service asserts that the rate for a single-piece basic First-Class stamp (now 37 cents) has kept pace with inflation since the 1970 Postal Reorganization Act. This is not an impressive achievement 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. And it is cause for concern that the huge investments in automation equipment and the widespread use of barcoding have not lowered the real price of a stamp. 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, newspapers believe that there are two reasons for this excessive First-Class rate. One is a failure to attribute costs properly between First-Class and Standard Mail largely as a result of incorrect or out-of-date costing information. The other is a long history of placing an excessive burden of the "institutional" or overhead 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 using Standard Mail.

As for institutional costs, the Honorable John McHugh, who chairs the Special Panel on Postal Reform in the House of Representatives, has called the leveling of First-Class Mail volume "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." This is a problem, however, only because the Postal Service has, for three decades, deliberately followed a model of placing the vast share of the institutional cost burden (upwards of 65 to 70 percent) on First-Class Mail, despite the fact that other classes provide nearly as much volume and the majority of the weight of the mailstream. Decades of exploiting its monopoly may now be coming back to haunt them, as citizens and small business mailers increasingly are exploring alternatives to First Class Mail delivery.

Pricing flexibility proposals could actually exacerbate the problem by allowing the Postal Service to raise First Class Mail rates to the maximum to pay for reduced rates for other customers, leading to the "death spiral" that postal stakeholders have talked about for many years. Pricing flexibility should serve the public by genuinely improving the process; it should not become merely an appealing-sounding label for preserving a broken model.

If the Postal Service is going to be given pricing flexibility, it must more accurately measure and allocate its attributable and institutional costs across product lines. Thus, 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." NAA believes a regulator should, in a separate proceeding, establish a methodology for calculating and allocating costs. 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 Postal Service.

Prior Review of Rate Changes

NAA respectfully submits that, whether or not a rate indexing system replaces the current cost-of-service system and regardless of costing changes, mailers would face considerable risk if the opportunity for prior review of rates—before implementation—were eliminated. Postal rates have profound economic consequences, and some deliberation is appropriate.

First, let me point out that prior review of rates does not necessarily mean delayed implementation of new rates. As a practical matter, the Postal Service must give at least 60 to 90 days advance notice of new rates in order to allow mailers to modify their mailing

software to reflect the new rates. This makes sense when one considers that postal rate changes affect every single resident and business in the nation. During this advance notice period, a regulator could review the proposed rate changes according to whatever substantive law governs ratemaking (particularly if costs are measured and attributed on the basis of methodologies established in advance) and step in if there is a *prima facie* basis for doing so.

Second, prior review is important because costs differ among classes. An unstated premise of rate indexing proposals appears to be a notion that costs rise more or less uniformly across classes. As the Postal Rate Commission advised this Committee last fall, that is not the case. Although postal costs in the aggregate may more or less track inflation, each class of mail uses a different mix of postal functions and the costs can vary widely. Looking at this at least on a *prima facie* basis before, not after, rate changes go into effect would help detect and prevent cross-subsidies at the outset, in a far simpler and efficient manner than an after-the-fact review. Excessive rates, even if refunded later, can pose harmful cash flow consequences on mailers. And one can foresee great practical difficulties in tracking payments in order to facilitate any refunds that subsequently might be required, much less in refunding postage to the many millions of private citizens that use First Class Mail.

To guard against these potential problems, NAA respectfully proposes that this Committee consider a prior review regime along the lines of models used by federal and state regulators in which the regulated entity publishes advance notice of an impending rate change, and that change takes effect absent intervention by the regulator. The Federal Communications Commission, for example, applied that procedure for many years before telecommunications became largely deregulated. In a similar manner, the postal regulator would have the discretion whether to let the rate change occur or, if *prima facie* cause exists, to order an expedited review of the change before it takes effect.

Rate Indexing Deserves Consideration

The Presidential Commission has recommended that the Postal Service should be allowed to set rates on its own within certain limits established by a 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. NAA supports consideration of an indexing approach to ratemaking assuming that certain safeguards are in place to protect mailers from flawed rates or undue discrimination.

Discriminatory Negotiated Service Agreements (NSAs) Should Be Prohibited

The Presidential Commission recommended allowing the Postal Service to negotiate special deals (or contract rates) with favored mailers, subject only to after-the-fact review. NAA respectfully opposes this recommendation.

First, as a matter of principle, NAA believes government services—here, postal services—should not be for sale on the basis of negotiating or lobbying skills.

Second, as a practical matter, and as the Postal Rate Commission has observed, arrangements negotiated privately between a mailer and the Postal Service could 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. (Indeed, this could be a motivation for the mailer seeking the NSA.) While external effects of this nature might pose no concern to a private business standing in the Postal Service's shoes, the Postal Service is a public service and, as such, has a public interest duty to consider factors beyond the immediate commercial implications of a particular deal. If it is unwilling to do so, it should not be able to enter into special deals with selected mailers.

Third, as a matter of policy and cost control, there is no reason why the benefits allegedly flowing from an NSA should be denied to other mailers. If a particular mailer activity can benefit the Postal Service, other mailers almost certainly can generate similar

benefits. Newspapers have long held the view that postal discounts and work-sharing arrangements should be available to all mailers–both large and small–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.

There is a big difference between (1) a negotiated service agreement that selectively confers unique benefits on a favored mailer, and (2) well-fashioned cost-based discounts that encourage and reward *all* mailers for work-sharing activities. By working with all mailers, the Postal Service would earn a far better return on its investment of time and effort than if it spends its energy and resources to negotiate special deals with individual mailers.

Finally, the Presidential Commission also recommended that negotiated service agreements should be made available to similarly-situated mailers. With this, we agree. However, it is important to recognize that such is not the case with the first NSA for Capital One Financial Services. More than 1 ½ years have elapsed since that agreement was announced, 10 months since it was approved by the Postal Rate Commission, and more than six months since it took effect, and no "similarly situated" or "functionally-equivalent" NSA has been proposed. In other words, the Postal Service has not made a similar NSA "available to others," particularly other financial institutions that may compete with Capital One. This is because the Postal Service holds the prerogative 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 can participate in a cost saving activity.

Conclusion

NAA appreciates the opportunity to provide the Committee with our views on postal reform, and specifically, on the subject of pricing flexibility. Newspapers look forward to working with the Committee on Governmental Affairs on comprehensive postal reform measures that strive to improve the Postal Service as an essential public service.

TESTIMONY

OF

H. ROBERT WIENTZEN
PRESIDENT & CEO
DIRECT MARKETING ASSOCIATION

BEFORE

SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS

MARCH 11, 2004

Chairman Collins, Members of the Committee, I am Bob Wientzen, President and CEO of the Direct Marketing Association (The DMA). I want to thank you on behalf of the 4,700 DMA-member companies and our 350 member Nonprofit Federation (DMANF) for inviting me to testify before you today on the important issue of postal reform.

Founded in 1917, The DMA is today the largest trade association in the database-driven direct and online marketing field, representing businesses – from small "mom and pop" operations to 53 of the Fortune 100 – in 52 industry sectors, including the nation's top catalogs, online marketers, retailers, manufacturers, financial institutions, publishers, healthcare, and new media providers.

The DMA Nonprofit Federation's more than 350 members consist of nonprofit religious, educational, and charitable organizations and professional fundraising consultants with particular expertise in direct-response fund raising. Federation membership consists of very large national organizations whose names are household words; smaller but still good-sized nonprofits with a high level of name recognition nationwide; and medium-sized, small, and local nonprofit organizations, even individual churches and synagogues.

The DMA's members – for-profit as well as nonprofit – use a number of marketing channels. However, direct mail, including catalogs, has been – and remains – a primary marketing channel to reach current and prospective customers and donors. In fact, direct mail in 2002 generated an economic impact estimated at $634.4 billion in the consumer and business-to-business segments alone, and nearly $50 billion was directly raised by nonprofits via the mail. In addition, many DMA members employ U.S. Postal Service (USPS) parcel and expedited delivery services for their fulfillment operations and account for a substantial portion of the First-Class mail stream.

In short, a viable U.S. Postal Service is vital to the future of The DMA's members and our industry.

As Rebecca Jewett, Vice Chairman of Norm Thompson Outfitters and Chairman of The DMA's Board of Directors, explained when she testified before the House Government Reform Task Force: postal reform is not about just the Postal Service, but rather about jobs and the economy throughout our nation.

That is reflected in the title of today's Committee hearing: "Sustaining the 9 Million Jobs in the $900 Billion Mailing Industry." Members of this Committee understand the gravity of the situation and the importance of moving swiftly to achieve comprehensive postal reform.

I am particularly pleased, as are many others in the business community, at the bipartisan and bicameral manner in which this matter is being addressed. As the late President Richard Nixon said 35 years ago this May in his message to Congress, in which he urged enactment of what ultimately became the Postal Reorganization Act of 1970, "There is no Democratic or Republican way of delivering the mail. There is only the right way." The same holds true for postal reform in 2004.

Your invitation to appear today asked that I speak to the legislative and administrative recommendations of the President's Commission on the United States Postal Service, and that I focus on those recommendations pertaining to the USPS's mission, the scope of its monopoly, its governance and structure, and rate setting flexibilities.

The President's Commission was charged with the responsibility of articulating a vision for the future of the Postal Service. The Commission's mission was of vital importance to The DMA's members and, indeed, all American businesses and consumers who use the U.S. mail.

In short, The DMA and the DMANF believe that the Commission met its goal by presenting a road map that builds on the past efforts of the Congress and the Postal Service, tackles tough decisions, and truly embraces the future. That road map builds on – and wisely so, I might add – the past efforts of this Committee as well as the USPS's "Transformation Plan," which was unveiled in April 2002.

One need only consider the extent to which the Postal Service's revenue base is being eroded by a rapidly changing communications and delivery landscape to appreciate the importance of consideration of each and every one of the Commission's recommendations in developing a new business model for the USPS.

At the foundation of the current, 34-year-old model that governs the Postal Service's current operations is a *de jure* monopoly that is under increased attack by rapid and ubiquitous technological advances, most notably the digital communications revolution. The Postal Service's revenue base is also being eroded by forces ranging from globalization and private-sector competition to the changing nature of logistics and transportation networks. Clearly, few – if any – of these changes could have been foreseen by the architects of the Postal Reorganization Act of 1970.

Moreover, it is unlikely that the current law's architects could have envisioned a time when the realities of a declining mail volume base (down about 5.5 billion pieces in the past three years and characterized by the President's Commission as "sobering and credible") would be required to support an ever-growing delivery network (approximately 5 million new delivery points over this same three-year period). Economically, this is an unsustainable situation, which, I believe, has further eroded an already shaky foundation on which today's Postal Service operates.

When he testified before this Committee last September, James A. Johnson, Co-Chairman of the President's Commission, was asked for an assessment of how long he thought the current system could be maintained before reaching the crisis stage. His response, I thought, was very insightful.

Co-Chairman Johnson offered that the Postal Service's financial situation was 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 Congress' efforts as well as those of the Postmaster General in strengthening the Postal Service's current financial standing. However, as Co-Chairman Johnson noted, the reality and the challenges of two years ago are still with us – and we do not have a long time to get it straight.

If we do not move ahead expeditiously with significant modernization, the choices facing the Postal Service – as outlined by Mr. Johnson and the Commission – will be dramatic service rollbacks, or rate increases of an unprecedented scale, or falling further into debt, which ultimately would require a taxpayer bailout. Each of these three options is equally unacceptable to me as a business person, as a taxpayer, and as the head of a broad association whose largest segment includes hundreds of nonprofit organizations. After all, this is a system that today supports those 9 million jobs and generates that $900 billion in sales – some 9 percent of our GDP. Therefore, it must be sustained.

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.

According to the President's Commission, the most significant obstacle to reform is a "legacy business model and structure counterproductive to the Postal Service's ability to perform its most vital function: ensuring the universal availability of reliable, affordable postal services."

This business and regulatory model, under which the Postal Service currently operates, provides neither the flexibility nor the incentives needed to ensure its own viability and, in turn, growth potential for the businesses and charitable organizations that rely so heavily on it.

When I testified before the President's Commission in February 2003, I offered, as an overall objective, that the underlying business and regulatory model of the USPS be updated in ways that:

- Ensure the continued availability of a system that provides users with a gateway to every home and business in our nation and beyond;
- Require the continuous pursuit of overall efficiency;
- Afford users an opportunity to achieve the lowest combined costs for the delivery of their mail; and,
- Maximize the benefits that competition can bring to our nation's postal system and economy.

The DMA believes that the Commission's report embraces these core principles.

GOVERNANCE

The President's Commission's report is infused with the notions that reforms must be couched within a dynamic context, if they are to serve future needs in an efficient and effective manner. Implicit in this notion is that the USPS must be empowered to right-size its infrastructure, workforce, and service offerings as future circumstances may dictate. These are concepts that The DMA believes should be first and foremost among those enacted by the Congress, along with the flexible, incentive-based rate-setting process envisioned by the Commission.

Nevertheless, while we support the creation of a model that will accommodate necessary changes, The DMA is cognizant of the need to distinguish between matters of operational efficiency and public policy and of the need to determine the appropriate degree to which the Congress should delegate authority in these arenas.

For example, the Commission noted that while universal service and the postal monopoly – as currently perceived – remain vital to the nation and its economy, such may not always be the case. Consequently, it said a review of this status, over time, may be appropriate, necessary, and possible, without sacrificing affordable access to essential services. We agree with this idea, in principle. However, in such matters, Congress may wish to explore retaining some degree of authority over this determination rather than vesting the matter wholly in a regulatory entity as proposed by the Commission.

On the other hand, the process recommended to facilitate infrastructure changes may require involvement by the Administration and the Congress to a degree that could impede the dynamic of operating in a way that maximizes efficiency. Although some degree of insulation from the political process is certainly desirable for realigning the Postal Service's network of over 400 logistics and processing facilities, the mechanism outlined by the Commission would appear to limit the USPS's modernization efforts to times when a special commission appointed by the President – with the advice and consent of the Senate – would submit recommendations requiring final approval by the President and Congress.

Regarding the Commission's proposal for restructuring the USPS Board of Governors, while I do not mean to slight any current or past members of the Board, I agree with the Commission's recommendation that primary consideration be given to selecting members based on their business acumen and other experience necessary to the management of an enterprise of the Postal Service's size and significance. However, I believe that the views expressed by USPS Board Chairman David Fineman concerning the potential for politicizing the Board (should the Commission's recommendation be followed in its entirety) have some validity.

Also, I would like to add a comment or two, if I may, concerning the makeup of the current Board. Chairman Fineman, who has done an excellent job in guiding the Postal Service on

reform and management matters, is currently in his so-called "holdover year." I hope he is permitted to continue to serve through the end of this year.

Moreover, that Chairman Fineman is in his holdover year raises another matter of some concern. There are currently two vacancies and two governors serving pursuant to recess appointments. Absent some action to fill vacancies, we may find ourselves with only four sitting governors and five empty seats at year's end.

FLEXIBILITY TO SET RATES

While the existing rate-setting scheme may have been tolerable in an earlier era, the length of time, complexity, and cost involved in litigating rate cases now results in diminishing returns for the Postal Service and its customers. The USPS, as does any business, needs pricing flexibility to meet the demands of the market.

In addition to a reasonable degree of flexibility to adjust rates, generally, the Postal Service's new business model should authorize customized service and rate agreements – also known as negotiated service agreements (NSAs) – that offer an economical benefit to the overall system as well as to the parties to such an 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 from the manner in which specific rates are developed, the magnitude and timing of rate changes are critical considerations for businesses and nonprofit organizations as they impact significantly their ability to plan and ensure their overall economic efficiency.

Our member companies – be they in direct mail catalog business, magazine publishing, or general advertising mail business – are having increasing difficulty accommodating rate increases that far exceed the general rate of inflation.

For example, catalogers have had to contend with a 22-percent rate increase, on average, over the past five years while the rate of inflation for this period was in the 14-percent range. As a result, we have reached the point where, in many cases, the cost of mailing a catalog or magazine equals or may even exceed the cost of producing that mail piece. This situation is counterproductive for the mailer and the USPS.

In the case of our nonprofit members, even rate increases at or below inflation are troublesome. They cannot raise their "prices" to cover higher postage costs *since, by their very nature, they rely on donations to fulfill their missions*. And if they cut their costs – that is, mail fewer solicitations – they will have less funds to do the good, important work on which we as a nation increasingly rely.

The DMA fully concurs with the President's Commission that preferential postage rate treatment in current law should continue for nonprofits and others. This important policy should be maintained to help foster the important charitable, educational, and informational work of these organizations. We believe, however, that the Commission inadvertently failed to include "books" in its preferential rate recommendation. Books should be included.

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 a government-created index 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, USPS management should be able to avoid lengthy, before-the-fact rate regulation if – *and only if* – rate adjustments are held BELOW inflation.

One final matter regarding pricing flexibility pertains to the Commission's concern pertaining to the percentage of total costs that remain assigned to specific types of mail and, therefore, is considered to be overhead or institutional costs. Congress should avoid calls to impose, in legislation, specific instructions to the Postal Regulatory Board to determine the costs of services offered. We have a vast 34-year record of examination by the Postal Rate Commission to determine the costs of services offered by the USPS.

I find it difficult to believe the claims that some firms are able to accurately assign 100 percent of all costs to specific services and, as a result, to price their services accordingly. If that were the case, they simply could not offer rates that were below published tariffs without adjusting the prices they charge others – unless those published tariffs do not reflect an accurate attribution of 100 percent of costs.

Let me be clear here, I do not begrudge nor criticize the practice of offering rates that deviate from published tariffs. But I do not think any reform package ought to place the Postal Service – and its customers – in a new, different pricing straightjacket by requiring that the USPS assign or attribute a specific higher percentage of costs mandated in legislation.

Likewise, USPS managers should be given latitude to distribute unassigned or overhead costs to products in a reasonable manner that responds to marketplace demands. To do otherwise in legislation would wash away all the flexibility given to the Postal Service.

WORKSHARING

The Postal Service's 25-year experience 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. Unbundling the various elements of the process has promoted economic efficiency by empowering those in the business and nonprofit mailing community to perform functions that result in the lowest combined postal-private cost of getting a mail piece from the drawing board to the mailbox.

According to the General Accounting Office (GAO), nearly three-quarters of all domestic mail is workshared, thus enabling the Postal Service to realize billions of dollars in savings. The total costs avoided by the USPS as a result of worksharing have been estimated to be in the range of $15 billion to $17 billion annually.

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.

I should mention here that the same GAO report notes that revenue from workshared mail exceeds the attributable cost associated with that mail and, thus, helps cover its fair share of overhead or institutional costs – and, probably, then some. This conclusion is consistent with the Postal Rate Commission's efforts to ensure that workshare discounts do not exceed avoided costs. The combined views of the PRC and the independent GAO should be sufficient to outweigh the claim by some that worksharing does not work and benefits only a few.

Equally important, especially at a time when all are concerned about declining volume, is the more than ample evidence that each new worksharing opportunity offered by the Postal Service has resulted in an upswing in volume.

Here, I would also like to touch on the President's Commission's recommendation for a base closing-like commission. It bears repeating here that implicit in capturing the full economic benefit of unbundling is that the Postal Service be vested with adequate authority to right-size its upstream "legacy" infrastructure.

The USPS 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.

WORKFORCE FLEXIBILTY

Increased worksharing and right-sizing of its network may mean a smaller internal Postal Service workforce over the long term. However, network changes need not precipitate Draconian changes for the dedicated USPS workforce. With nearly half of career employees eligible for retirement by decade's end, this presents an opportunity to couple network changes and workforce attrition in a thoughtful and fair manner.

To mitigate the impact of network realignment on rank-and-file employees, Postal Service management and employee groups must use the bargaining and consultation processes to explore the liberalization of work rules. Requiring the USPS 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 as 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.

Moreover, while I support fair and full collective bargaining, an addition to existing law should require arbitrators to give weight to the changing nature of the communications and delivery landscape, as well as the importance of achieving productivity gains as a means of ensuring the viability of the postal system.

On the matter of workers' compensation, I find myself in general agreement with the President's Commission. Although there may be other areas, this is one area where some change is in order.

Most certainly this is true when it comes to the point in time an injured worker is eligible for the same retirement benefits he or she would have received had there been no job-related injury.

Before moving on to the next topic, I want to comment briefly on what seems, at times, to be a fixation with the percentage of labor-related costs – reported variously in the 75-80 percent range. Let me make clear, if my previous comment on workers' compensation did not do so, I am not opposed to labor representing a lesser percentage of total Postal Service costs. However, I believe the primary focus of any effort – legislative or otherwise – should be on worksharing, partnering, and right-sizing as means of increasing USPS efficiency. If we do this, whatever the percentage labor costs actually represent, it will be of a smaller dollar figure.

I understand that your staff is working with employee groups to find solutions to improve efficiency and the collective bargaining process. The DMA wholeheartedly supports those efforts. In fact, The DMA and, I am certain, other mailer groups stand ready to assist you in these efforts. Any effort to help sustain the $900 billion, 9 million employee postal industry – including the U.S. Postal Service – needs the input of all involved. Please keep up this important dialogue with postal employees.

UNIVERSAL SERVICE

With some limited exceptions, the U.S. Postal Service delivers to everyone, everywhere, six days a week. I support its continuation. Delivery service to the American public, charities, and 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 USPS service offering, which our members have used to deliver a significant proportion of products to customers. 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.

CIVIL SERVICE RETIREMENT ISSUES

I know you are all too familiar with the last topic I would like to discuss. It is, nevertheless, important to emphasize our concern.

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), which was enacted 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 USPS 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 rather than postal ratepayers, which is the same way 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 United States Treasury for payments already made. At the very least, mailers should not be responsible to reimburse the government for past payments to retirees.

Another aspect of the last year's 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, based upon the old over-funding CSRS formula, the current escrow law would force that sad occurrence and, thus, force mailers to pay higher than needed postage rates. Current estimates suggest that without CSRS reform, the new rates would increase an additional 5.4 percentage points. That is not healthy for the economy, the mailers, and certainly not the Postal Service.

SUMMARY

In closing, I want to endorse the Presidential 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 legislation to further ensure the Postal Service's financial stability.

I thank you for the time you have taken and the attention you have given this important matter. I look forward to working with you and your House counterparts to achieving meaningful reforms for our postal system.

March 9, 2004

"Postal Reform: Sustaining the 9 Million Jobs In the $900 Billion Mailing Industry"

Written Testimony Prepared for
Senate Committee on Governmental Affairs

by

The Instant Web Companies
James N. Andersen
President and CEO

Chairwoman Collins and Members of the Committee, thank you for the opportunity to provide testimony on the critical issue of reforming our United States Postal Service. We appreciate your leadership and the bi-partisan efforts of Chairwoman Collins and Senator Carper to draft legislation that drives comprehensive postal reform.

The Instant Web Companies (IWCO), headquartered in Chanhassen, Minnesota, has served the needs of North America's leading direct marketers for more than 35 years. Our integrated manufacturing services include printing, plastics, envelope manufacturing, and mailing. As such, our testimony represents the impact of postal reform on many manufacturing and service industries including paper manufacturers, printers, envelope converters, and mailers, as well as our clients who use our direct mail packages and the USPS to acquire new customers and build loyalty with existing customers.

IWCO is committed to working with you to create an environment in which the USPS, its customers, the mail industry and our national economy can flourish.

Executive Summary

The United States Postal Service (USPS) is the cornerstone of a $900 billion industry that accounts for eight percent of the country's gross domestic product. This industry employs nine million Americans in manufacturing, technical, professional, and administrative jobs. Postal reform is necessary to address numerous tactical issues faced by the USPS and the mailing industry. But postal reform legislation must be written to strategically transform the USPS to an enterprise for the 21st century that embraces proven business strategies, private-sector partnerships, and new technologies. Transformation of the USPS will result in costs being managed and service improved.

Comprehensive postal reform, including pension reform measures, must be enacted into law. As the President's Commission noted, "Absent fundamental reforms, the risk of a significant taxpayer bailout or dramatic postage-rate increases looms large." Jobs are at risk without significant postal reform resulting in *long-term* rate stability.

In our view postal reform legislation should include the following points put forward by the President's Commission:

- The USPS should remain a public institution that focuses on its core competency of reliable, affordable delivery of hard copy materials.
- The postal regulatory function should be enhanced to include the power to establish service standards and financial transparency standards as well as reviewing postage rates.

- The USPS should be allowed greater flexibility in rate making including the ability to set rates for monopoly products within pre-established guidelines. Regulatory review should be limited to rates exceeding the guidelines or based on an after-the-fact challenge.
- The USPS should be allowed greater flexibility to realign their logistics and retail networks to meet current demands. The Commission's proposal for a Postal Network Optimization Commission to help address this issue has particular merit.
- While postal facilities can provide benefits to their local communities beyond the delivery of universal postal service, support for those facilities not essential to meeting the universal service obligation should come from appropriations from the general budget, not from ratepayers.
- Worksharing partnerships between the USPS and the private sector have proven to be successful in advancing service and reducing costs, to the mutual benefit of the USPS and the mailing community. The USPS should be encouraged to maintain and expand these relationships.

Eighteen of the 35 recommendations of the President's Commission do not require legislative changes. We urge the Governmental Affairs Committee to encourage the USPS to continue the active pursuit and implementation of these recommendations without waiting for final reform legislation.

The USPS Should Remain a Public Institution Providing Universal Service

In the words of the President's Commission, "the 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." The private sector cannot provide the universal mail services that Americans trust and depend on from the USPS.

Like any business, the USPS must focus on developing and strengthening its core competency. The core competency of the USPS has been identified as the "last mile" service it securely provides to every home and business in the country. Proven business models must be applied to drive efficiency and reduce cost while improving service.

Cost-effectiveness must be an explicit obligation of universal service. Affordability must not be a result of a decline in service. A mechanism must be put in place that requires the periodic review of universal service to ensure that service obligations adapt to changes in the consumer and business marketplace.

The decline in first class mail volume must be addressed with innovative solutions including Negotiated Service Agreements (NSAs) and guaranteed delivery windows for first class mail. Rather than hoping that a check mailed on Monday reaches their credit card company by Wednesday, consumers have turned to the Internet to pay bills through a system that issues a receipt showing payment received on time to avoid a $35 late charge. Consumers are not trying to save 37 cents on a first class stamp – they are

guaranteeing they will not be assessed the $35 late fee. Most would feel more secure writing a check that is securely processed by the USPS if first class mail had the same delivery guarantee as online bill payment.

The Postal Regulatory Function, Rate-making and Service Standards

The postal regulatory function should be enhanced to include the power to establish service standards and financial transparency standards as well as reviewing postage rates. An independent Postal Regulatory Board should be established to provide oversight of the USPS.

A process must be implemented to streamline rate-making and rates must be market driven. A cap on annual rate increases should be considered so that businesses can effectively plan the mail marketing programs that drive the acquisition of new customers and retention and growth of existing customers. The rate-making review process must be changed to focus on key issues that drive results rather than endless and time-consuming pages of testimony. In short, the rate setting process must be more immediate to reduce the time between the expressed need by the USPS and the decision.

Service standards must be established, published, and monitored. A framework of accountability must be developed. Performance results based on service standards must be reported with corrective action plans required for sub-standard performance. Pay for performance models should be investigated with management incentives issued for exceeding performance, not merely meeting the standard.

Greater flexibility to realign logistics and retail networks to meet current demands.

The elimination or reorganization of inefficient and unprofitable existing operations must be addressed. The Postal Reorganization Act of 1970 prohibits the USPS from closing a small post office based solely on economic factors. Thirty years later, a new set of criteria must be developed and implemented to address economic and social factors in the context of the long-term viability of the USPS.

The President's Commission recognizes the political sensitivity of closing small post offices and did not directly call for action. The Commission did recommend that Congress ease restrictions on closing post offices and urged a more creative and proactive approach to working with communities on facility issues.

Senator Thomas Carper (D-DE) has proposed creation of a commission similar to the military's Commission on Base Realignment and Closure. The President's Commission has endorsed this proposal. IWCO supports this solution as an effective way to remove politics from the closure process and make closing and consolidation of postal facilities a workable component of postal reform and transformation.

In addition to a more evolved and market savvy approach to the retail network, the USPS must address the efficiency and effectiveness of its distribution and logistics network. Redundancies must be removed and capacity must be evaluated to ensure productivity and performance standards can be met. Once again, this is a core business model employed by the private sector to drive growth and profitability.

As a result of consolidating facilities, removing redundancies, and establishing and monitoring performance standards, our business has grown 40% over three years and we have added 180 manufacturing jobs with no additions to corporate staff. The USPS must take the same approach to develop a logistics network that reduces cost, maximizes efficiency, and optimizes service and quality.

Worksharing to Drive Productivity and Reduce Cost

The USPS should encourage worksharing agreements with the private sector. Worksharing reduces cost for the USPS and provides rate reduction incentives for business mailers. While the benefits of worksharing are widely recognized, the process for implementing worksharing agreements is tedious and depends on business rules that were established more than 30 years ago.

The USPS must engage in worksharing agreements with the private sector with business models from the private sector. Standards for pricing and performance must be established through measurement and forecasting models agreed to by both parties. Incentives must be established which benefit both the USPS and the private sector. Once again, the USPS should focus on its core competency of "last mile" service, and provide incentives for the private sector to absorb additional work that will help the USPS to bypass inefficient transportation and delivery streams encountered on the way to the last mile.

Conclusion

Universal postal service must be preserved and allowed to operate efficiently and effectively for every American household, business, and the $900 billion mailing industry that requires a strong and thriving United States Postal Service. The need for postal reform is urgent and the need for transformation of the USPS to the 21st century is essential to nine million US-based jobs and a recovering economy. We cannot have continuing increases in postage rates without an adverse impact on jobs. Legislation that strengthens reliable and affordable universal mail delivery will protect nine million jobs nationally and more than 195,000 jobs in the state of Minnesota (including 1,000 jobs at IWCO facilities in Little Falls and Chanhassen).

The USPS must implement many of the practices employed by the private sector to reduce cost, reduce waste, increase efficiency and drive growth. Continuous improvement programs with published standards that are monitored and reported must be implemented and management must be accountable for the success of these programs in meeting the needs of its business and consumer customers. The USPS must be transformed from an operationally driven organization to a market driven organization.

Programs must be implemented to drive volume with pricing structures and worksharing incentives that offer benefits and the continued use of the mail as a non-intrusive and secure marketing channel

IWCO stands ready to work with you to create an environment in which the Postal Service, its customers, the mail industry and our national economy can flourish.

About The Instant Web Companies

The Instant Web Companies, headquartered in Chanhassen, MN, has served the needs of North American direct marketers for more than 35 years. IWCO provides direct mail like no one else by seamlessly integrating direct mail services from a primary campus resulting in streamlined production for all components – printing, plastics, envelope conversion and mailing. IWCO's industry experience and technology along with proprietary IWCO P.O.S.T. (Postal Optimization Strategy and Technologies) and RideShare™ commingling and logistics management programs deliver dramatic postage savings and faster time to market.

AMERICAN FOREST & PAPER ASSOCIATION

GROWING WITH AMERICA SINCE 1861

U.S. Senate Committee on Governmental Affairs
March 11, 2004

Postal Reform: Sustaining the 9 Million Jobs in the $900 Billion Mailing Industry

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American Forest & Paper Association
Statement for the Record

The American Forest & Paper Association (AF&PA) welcomes this opportunity to present its views on legislative initiatives to reform the United States Postal Service (USPS). AF&PA is the national trade association of the forest and paper industry and represents more than 220 member companies and related associations that engage in or represent the manufacturers of pulp, paper, paperboard and wood products. AF&PA and the allied paper products industry (composed of pulp, paper and paperboard mills as well as plants that convert primary paper into envelopes, stationery, and boxes) provide the raw materials for paper-based communications – much of which is transmitted via the Postal Service.

AF&PA is pleased to offer the assistance and perspective of the forest and paper products industry as the Congress considers postal reform legislation during the Second Session of the 108th Congress. AF&PA supported the creation of the President's Commission on the United States Postal Service, welcomed its final report, and supported legislative measures aimed at strengthening the financial viability of the USPS. We intend to continue our concentration on this issue, specifically on measures that substantially reform and modernize the USPS.

IMPORTANCE OF THE UNITED STATES POSTAL SERVICE

AF&PA shares Congress' recognition of the importance of the USPS to the U.S. domestic economy. The overall mail-related community encompasses not only the USPS itself, but the mailing, printing, production, and delivery industries as well. The total impact on the economy is $900 billion and the employment of 9 million Americans. AF&PA continues to support postal reform initiatives so that this 9% aspect of our Gross Domestic Product continues to survive and succeed in the future.

The financial status of the USPS is of great interest to the AF&PA membership, as the paper products industry and its major customers are heavily involved in the postal shipping process. Our printing, writing, and packaging products account for a vast majority of the items that pass through the mail system. In 2001 alone, almost 10 million tons of mail – about a third of U.S. paper demand – was shipped through the three main classes of mail. Over 70% of mail volume was in the form of paper industry products. In essence the Postal Service serves as the foundation of communications for both large and small businesses as well as their customers. Recognizing its importance to the domestic economy, AF&PA strongly supports

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America's Forest & Paper People® - Improving Tomorrow's Environment Today®

legislative initiatives that will encourage the Postal Service to improve service, reduce costs, and respond to a changing marketplace.

RATE FLEXIBILITY

AF&PA economic research and the experiences of our member companies in recent years have demonstrated that changes in postal shipments strongly correlate with corresponding shifts in demand for printing and writing paper. The amount of printing and writing paper purchased by our customers has a direct relationship to the volume of mail that moves through the USPS system. In turn, mail volume is tied to Postal Service revenues. The greater the volume of mail, the greater the revenue received by the Postal Service and opportunities increase for economies of scale. Conversely, when the postal service mail volume decreases, cost increases typically exceed revenue increases.

In recent years, the more the Postal Service has raised rates to offset lost revenue from volume declines, the more volume it has lost. AF&PA data shows that shipments of mail trend downward as a result of postal rate increases. For example, eight straight quarters of decline in shipments occurred after a recent 24% increase in postage for periodical shipments. This is equivalent to a loss of demand of almost half a million tons of paper on an annualized basis, three quarters of which is estimated to be magazine paper.

As the Postal Service has experienced a recent decline in mail volumes, AF&PA's members and their customers have felt the upstream impact. Since 1997, paper companies have closed 98 mills and lost about 50,000 jobs. The decline in mail processed through the Postal Service is one factor accounting for these losses.

Postal rate increases have direct negative impacts on the paper products industry. We continue to support several reform initiatives that will increase efficiencies, reduce costs and maximize volume and revenue in the USPS. We believe cost cutting and efficiencies will best ensure the long-term financial viability of the Postal Service. However, if rate adjustments are absolutely necessary in the future, AF&PA strongly supports legislative initiatives that will help assure stability and predictability in the ratemaking process and permit businesses that depend on the postal service to build these potential cost increases into their business plans.

Specifically, AF&PA urges Congress to ensure that any rate increases are limited to the rate of inflation, and that they occur no more than once per year. These statutory measures will enable the many industries that use paper products for mailing purposes to mitigate the cost increases in their business plans. In recent years we have seen large rate increases in short time spans. These unpredictable rate increases wreak havoc on business planning and lead to instability in the mailing industry as well as lost volume in the postal system which in turn leads to higher costs and lower revenues. A more predictable ratemaking process will help not only businesses, but also the Postal Service as everyone will have a better opportunity to plan for the rate increases.

WORKFORCE

AF&PA recognizes that reforming the postal workforce is perhaps the most contentious of the issues facing the USPS as it moves into the 21st Century. Considering the numerous challenges facing the USPS at this time, it is essential that all issues, including workforce issues, be examined for potential reforms. We believe it is possible for changes to be undertaken that will not drastically affect the postal workforce in an adverse way.

The paper products industry has instituted many workplace efficiencies over recent years that have reduced operating expenses and permitted additional funding for employee incentive programs. A similar plan may be successful for the USPS as well. A recent General Accounting Office study indicated that $15 billion to $17 billion annually could be saved by instituting worksharing in the mail processing and delivery systems. AF&PA urges the Congress to consider expansion of the worksharing and private sector in which the USPS already participates. Furthermore, we believe Congress should encourage initiatives that would grant the Postal Service the flexibility to pay competitive wages, measure job performance, and reward and penalize accordingly.

AF&PA also supports giving the USPS the flexibility to right-size its workforce to meet the changing marketplace of today and the future. Nearly half of the current employees of the Postal Service will become eligible for retirement by the end of the decade. This natural attrition will permit the USPS to undergo a workforce reduction without a negative impact on most current employees.

Finally, AF&PA shares the concern of the President's Commission and several Members of Congress regarding the USPS liability for workers' compensation costs. In its 2003 annual report, the Postal Service claims that its total workers' compensation liability to be $7.2 billion. This cost, if left unchecked, could significantly damage the financial viability of the USPS now and in the future. The paper products industry has also faced considerable workers' compensation costs in recent years, and has employed management tools to mitigate them. We believe that the Postal Service must make comparable reforms in order to deal with such liability. AF&PA encourages the Congress to consider several of the recommendations made by the President's Commission regarding this issue. Imposing a three-day waiting period before the commencement of benefits, limiting the size of the benefits, and moving employees to retirement pay from worker's compensation pay at the appropriate age are all suitable measures of reform that will further secure the financial viability of the USPS.

CIVIL SERVICE RETIREMENT

We were pleased with the passage of last year's Postal Civil Service Retirement Funding Reform Act (Public Law 108-18) and thank the Congress for its support and leadership in that effort. This law corrected the USPS liability to the Civil Service Retirement System (CSRS) and helped to forestall unwise postal rate increase that would have occurred just as the economy was beginning to show signs of growth.

However, a consequence of this law that concerns AF&PA is the requirement that the USPS fully and independently finance the pension benefits of its employees who served in the military. This policy will not only represent an undue financial strain on the USPS, but also contradicts the statement of the President's Commission that "Taxpayers, not ratepayers, should finance military pensions." AF&PA agrees with this principle, and, therefore, believes that the responsibility for funding CSRS benefits relating to the military service of Postal Service retirees should be returned to the Department of the Treasury.

Furthermore, the law requires the USPS to maintain an escrow account containing funds estimated to fully fund retirement when deciding future rate adjustments. AF&PA believes that this escrow account will force postal rates to increase unnecessarily, especially since last year's law already corrected the CSRS liability of the USPS. Repealing the escrow provision from Public Law 108-18 and returning military service obligations to Treasury would both be legislative initiatives that lessen the likelihood of a significant postal rate increase in the future. Such an increase would have negative financial impact on not only the paper products industry, but also other industries involved in the mailing process.

Thank you again for this opportunity to offer our thoughts on the postal reform legislative initiatives facing Congress this year. As we have in the past, AF&PA continues to support universal postal service and continuing delivery to every household in the country. However, our members in the paper products industry know from experience that sudden and significant postal rate increases reduce mail volume, decreasing demand for their products. Therefore, AF&PA strongly supports measures of reform that will permit the USPS to reduce costs and more effectively manage its workforce in order prevent such increases from occurring.

BEFORE THE COMMITTEE ON GOVERNMENT AFFAIRS
UNITED STATES SENATE
STATEMENT OF CHRISTOPHER McCORMICK,
PRESIDENT AND CEO, LL BEAN

My name is Christopher McCormick, I am the President and CEO of LL Bean. I am submitting this statement on behalf of LL Bean and the Mail Order Association of America (MOAA). LL Bean is a member of MOAA, whose members have a broad interest in the Postal Service, and in particular, the use of the mail to send catalogs to their customers.

Introduction

The 1970 Postal Reorganization Act ("PRA") provided that the "Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary and business correspondence of the people."[1] The Postal Service has performed its "basic function" admirably. It has served to bind the nation together, and in the business correspondence arena has enabled the growth of a catalog industry that gives access to a broad array of products which can be ordered from the convenience of consumers' homes and businesses. This has been accomplished while meeting the PRA's requirement that the Service be self-supporting; mailers, not taxpayers, have paid the costs of universal postal service. In sum, the Postal Service has been able to meet the postal policy established by the PRA.

It has now become clear, however, that substantial change is needed if the Postal Service is to be able to continue to meet the nation's postal needs. As concluded by the President's Commission,

[1] PRA §101.

in the absence of significant change "the Postal Service will have three choices: dramatically reduce service, seek a rate increase of unprecedented scale, or fall even further into debt, potentially requiring a significant tax-payer bailout."[2]

The General Accounting Office has addressed the peril facing the Postal Service in a series of reports and in testimony delivered to both this Committee and the House Committee. Most recently, Comptroller General Walker in testimony before the Special Panel on Postal Reform of the House Committee on Government Reform set forth in detail the perils facing the Postal Service. Those include declining mail volumes, declining revenue growth, declining increases in productivity and other challenges to its future.

Postmaster General Potter also recognized the grave difficulties facing the Postal Service. In his testimony before the Special Panel on Postal Reform and Oversight, he noted that mail volume declined in each of the last three years with an overall decline of more than 5 billion pieces, representing a $4.5 billion reduction in revenue. Those losses are particularly alarming given the fact that during that same three year period the number of addresses served by the Postal Service increased by 5.4 million.

Simply stated, the Postal Service is faced with an inexorable loss of business due to such factors as the internet as used for both business and personal correspondence, and equally inexorable increases in the scope of its required service because of a growing population.

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[2] Report at V.

In recognition of the above factors the President's Commission concluded that an "incremental approach to Postal Service reform will yield too little too late given the enterprise's bleak fiscal outlook, the depth of current debt in unfunded obligations, the downward trend in First-Class Mail volumes and the limited potential of its legacy postal network that was built for a bygone era".[3]

The President's Commission made a number of recommendations that can be carried out by the Postal Service without legislative change. We have been impressed with the determination of the Postal Service, under the able leadership of Postmaster General Potter, to bring about the kinds of changes that will be necessary to enable the Postal Service to continue to prosper. We know that this Committee in its oversight capacity will continue to work with the Service to facilitate accomplishment of the reforms set forth in the Transformation Plan and the Commission's Report.

The Commission also concluded that legislative changes are essential. We strongly urge this Committee to adopt legislation that is equal to the challenges facing the Service. To do otherwise not only invites, but virtually guarantees, failure. The net result of enactment of anything other than fundamental reform will not resolve the problem. Rather, in the near future Congress will again be called upon to address the issue.

The President's Commission recommended that the Postal Service confine its activities to those essential to its task of collecting and delivering "mail". Although the Postal Service may want

[3] Report at V.

to expand its authority slightly from this constraint, it appears that the Service, the mailers and the Congress all recognize that the Postal Service has as its fundamental mission the collection and delivery of hardcopy mail and that the solution to its problems cannot be found by attempting to expand that mission.

We agree with that conclusion, but it serves to bring into stark focus the dilemma that the Postal Service faces. Suppose, for example, we were assessing the Postal Service as a business for possible acquisition. What we see is a business with declining volumes due to structural changes in the communications market which are beyond its power to control; increasing costs because of increasing delivery stops resulting from a growing population and an inability to diversify into other businesses. Certainly, this is not a business which would draw top dollar as a takeover candidate.

The Postal Service summarized its dilemma some years ago as a lack of control over "people, products and prices". That remains an accurate formulation of the problem and a good road map for the legislative changes that need to be made. This testimony will address those areas.

Rate and Classification Flexibility

Changes in the statutory provisions governing the establishment of postal rates and classifications are at the heart of needed legislative reform. The Administration has set forth five principles that should govern reform legislation. One of those principles is that postal management should "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."[4] That principle, we submit, requires Congress to determine the parameters of the Postal Service's rate and classification authority. Within those parameters, postal management should be given the right to establish rates and classifications.

The current role of the Postal Rate Commission, which makes independent "management" judgments on rates and classifications, should be ended. The 1970 Senate Committee Report accompanying the Postal Reorganization Act was prescient in recognizing the possibility that dividing the authority to establish rates and classifications between the Postal Service and the regulatory body might ultimately fail:

> The committee envisions the Commission to be an integral part of the postal service, to be 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.[5]

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[4] Department of Treasury Press Release, December 8, 2003,

[5] Rep. No. 91-912, at 13, 1970.

Unfortunately, the feared "bureaucratic struggle" has developed. All too often, the Commission has not deemed itself to be a "true partner" of the Board of Governors, but a body with better views on proper rates and classifications. Further, escape from PRC decisions is exceedingly difficult. The Postal Service can change a PRC recommended decision only by unanimous vote of the Governors and only by finding that the recommended rates would fail to produce needed revenues. It cannot override the PRC because it has made flawed rate and classification decisions that fail to respond to the needs of a "dynamic marketplace." Although the degree of antagonism between the Postal Service and the Board of Governors has varied from time to time, the very structure of the statute, dividing responsibility for establishing rates and classifications, probably made inevitable the kind of conflict that has developed. The problem should be resolved by separating the management responsibility for establishing rates and classifications from the regulatory function of ensuring compliance with legislative requirements. Congress should establish clear and enforceable requirements within which the Postal Service will have the management authority to establish market driven rates. Unless, the Postal Service is given the authority to "reduce costs, set rates, and adjust key aspects of its business", reform legislation will fail.

The President's Commission recognized the need to reform the existing system of setting postal rates, including the need to provide greater rate flexibility to the Postal Service. We cannot agree, however, with the Commission's recommendation that the authority to determine the Service's discretion be vested in a newly created Postal Regulatory Board. That Board, under the Commission's recommendations, would also be authorized to determine the scope of universal service and the scope of the postal monopoly. We strongly believe that those

fundamental policy judgments should be made by Congress. The Board should be assured of obtaining from the Postal Service all of the data needed to perform its role. The Board's use of those data, however, should be to ensure that the rate and classification decisions are within the legislative parameters; they should not be used to second-guess management decisions. Reform legislation should revise and rationalize the statutory "factors" guiding rate and classification decisions. The current PRA factors are so vague, and self-contradictory, that they can serve to support virtually any imaginable set of rates. For example, factor 5, the availability of alternate means of sending and receiving mail, has been interpreted both as a factor justifying higher rates, and a factor justifying lower rates. It is also imperative that market realities, as measured by relative demand, be given greater importance in establishing rates. The only pricing avenue open to the Postal Service to protect and increase its volumes is to recognize the "dynamic marketplace" when setting its rates and product offerings.

The Postal Service should be given authority to establish rates without review provided that those rates do not exceed a statutorily established "price cap". The overall price cap should be set at a level which provides real pressure to restrain costs, but is not so stringent that failure would be inevitable. Within the overall price caps for broad categories or "baskets" of products, *e.g.* First Class Mail, Periodicals and all other mail, the Service should be able to adjust rates for particular products to reflect changing patterns of costs and market demand.

We also recognize that the Congress may determine that for some products the marketplace should not be the sole or perhaps even a significant determinant of rates. For example, the educational or cultural value of certain kinds of mail such as periodicals may be such that the

marketplace should play little if any role in pricing. To the extent that Congress makes those judgments it should adopt explicit statutory requirements *e.g.* providing that the rates for periodicals will be attributable costs plus a percentage of those costs. This is an approach which has already been adopted for non-profit mail and is far preferable to continuing a pattern of giving the marketplace too little importance in the establishment of postal rates because of a concern over the affect of that approach on particular types of mail.

Workforce

Reform legislation should also address the "people" or workforce issue. First, I would like to affirm that we have the greatest respect for the Postal Service and its employees. Those employees have served this nation well and are entitled to be proud of their record of high quality mail service over many years. Certainly, the Service and its employees have well-served the interests of catalog retailers.

Further, we strongly support collective bargaining. Nothing should be done to impede employees' rights to continue to bargain with the Postal Service. Thus, we must disagree with the Commission's recommendations that pay comparability be determined by a Postal Regulatory Board, a determination that would be absolute and binding upon all new employees. To divest employees of bargaining rights, and instead invest authority in the Board, is unacceptable. Although the issue of pay comparability should be on the collective bargaining table, its resolution should be left to that process.

We also support an expansion of collective bargaining to include all benefits enjoyed by postal employees. Including benefits as a part of collective bargaining is fundamental to the proposition that employees ought to be able to bargain for all elements of compensation, a position which labor unions across this country have fought to establish and maintain. We also believe that incorporating pay for performance incentives would benefit both employees and the mailing customers they serve.

The worker's compensation system should be reformed. The President's Commission's Report noted, among other things, that the system as it now exists encourages and virtually mandates that employees stay in workman's compensation long past what occurs in other sectors simply because it is financially advantageous to do so.[6] The Congress should adopt a different approach, an approach which fully compensates employees, without inviting abuse.

Postal Facilities

Vital to improving the efficiency of the Service is ensuring the optimal number, size, locations and structure of its facilities. The President's Commission recognized that the current physical structure of the Postal Service is not designed to ensure the greatest possible efficiency. We urge this Committee to make it clear that the location, size and operational structure of the Service's physical facilities should be driven by efficiency, subject only to adequate levels of service.

With respect to its physical facilities, however, the Congress may want to distinguish between the mail processing and distribution centers, which account for the great bulk of costs, and small

[6] Report at 133, 134

post offices. Specifically, the Congress may want to consider the fact that small post offices may have an importance to communities that is worth preserving even if mail services could be provided less expensively for those communities by alternative arrangements.

We recognize that the location of the Postal Service's facilities has been, and will remain, a political issue. Given the Service's peril, however, the Congress should do everything that is possible to ensure that the Postal Service is acting in the best interests of the entire country in making decisions on the size, nature and locations of its physical facilities. It should be made more difficult for management decisions to be thwarted by political considerations.

Competitive and Non-competitive Products

The various versions of reform legislation that have been considered over the last few years have divided postal products into "competitive" and "non-competitive". It is essential, however, for this Committee to recognize that this does not mean that the "non-competitive" products are without competition. As recognized by the President's Commission and the GAO, electronic alternatives have diverted large volumes of communications that would otherwise have been sent as First-Class Mail, a "non-competitive" class. That diversion is virtually complete for business to business financial transactions and is taking place at an accelerating pace for individual consumer transactions such as billing and payments. The cost advantages of electronic communications for those transactions is so enormous that the Postal Service will be unable to recapture volumes or prevent further diversions through a pricing or any other strategy.

Other types of mail, particularly Standard Mail, are also subject to diversion from alternative delivery, including that offered by newspapers, and increasingly, electronic alternatives. Fortunately, however, the Postal Service is in a position to compete for these volumes and will be able to do so for an extended period. Success, however, will require the Postal Service to price its products as required by a "dynamic marketplace", as recognized by the Administration's principles. A failure to do so will inevitably result in postal rates that will accelerate volume declines and result in even higher rates for all mail, including First-Class Mail. In sum, the Postal Service must be able to engage in realistic pricing for all products, competitive and non-competitive, if it is going to be able to serve the needs of the nation.

Postal Monopoly

The issue of the postal monopoly should be addressed by this Committee. We recognize that the monopoly has been deemed necessary to universal service. We support the continuation of universal service, with some flexibility on what constitutes "universal service". Regardless of how interpreted, however, and even if deemed to require the continuation of six day-a-week delivery to every address in the country, there are substantial questions about whether the monopoly assists in maintaining universal service.

The mail volume losses that have occurred and will continue to occur, particularly within First-Class Mail, have taken place, despite the monopoly, through the use of electronic alternatives and materials carried outside of the Postal Service by carriers such as Federal Express and United Parcel Service. Those trends are going to continue and constitute the real threat to postal volumes. The losses will not be stopped by a continuation of the monopoly. The only way of

truly protecting postal revenues would be to broaden the monopoly to include all hard copy and parcel products, and precluding all private competition. Obviously, we would not support any such legislative move, nor would anyone else. At the same time, the continuation of the monopoly has been used to justify overly restrictive control of Postal Service pricing and product decisions. The ability of competitors to obtain non-marketplace pricing by relying upon the "monopoly" has resulted in more harm to postal revenues than any protection afforded by the monopoly. The Postal Service would gain more by doing away with the monopoly, and being given the kind of rate freedom which we believe is essential for its continued prosperity, than by continuing the illusion that the monopoly is protecting revenues and universal service.

It is now generally recognized that heavy handed regulation of enterprises providing services often does more harm than good. There needs to be sufficient regulation of the Service to ensure that the monopoly, assuming its continuation, is not misused. Further, with or without the monopoly, reform legislation should establish requirements that ensure that the Service meets the needs of the Nation and does not abuse its authority. Within those parameters, however, the Postal Service's ability to meet the needs of the nation can be ensured only by giving it considerably more freedom to "set rates, and adjust key aspects of its business" than it now enjoys.

CSRS Issues

We join other mailers in urging Congress to take the necessary action to relieve the Postal Service from the obligation to collect from mailers, and pay into "escrow", billions of dollars in retirement costs that are not owed, as now required by the CSRS legislation. It need not be extensively argued that at a time when the Postal Service is facing grave financial difficulties it is

counter-productive to impose phantom costs upon the Postal Service, the net result of which would increase rate levels by more than 5 percent. For the same reason, the Postal Service should not be required to meet the retirement costs attributable to employees' military service. No other federal agency is required to meet such costs and there is no rational basis for imposing the obligation upon the Service.

Summary and Conclusion

A frequently quoted conclusion of the President's Commission is that "an incremental approach to Postal Service reform will be "too little too late ...." We agree with that conclusion, but fundamentally disagree with the Commission's recommendation that a Postal Regulatory Board be established which would have plenary control over postal rates and classifications, the scope of universal service and the extent of the postal monopoly. That is exactly the wrong direction for postal reform. Instead, those important policy issues should be decided by Congress, particularly including the degree of rate freedom that should be enjoyed by the Postal Service. The regulatory body should then have the responsibility of enforcing those legislatively-established policies, but its role should be to enforce the law; not to second-guess postal management on the precise product offerings and rates for its services.

There also have been suggestions that there should be a base line rate case. The scope of the Service's pricing authority, however, should be determined by legislation and should be effective immediately. We fail to understand why a base line case is necessary or how it would accomplish anything other than delaying the institution of a reformed pricing regime. At the very least, if there is to be a base line rate case, it should be pursuant to newly formulated and

market driven pricing factors rather than those which have not proved to be an effective means for determining prices in today's "dynamic marketplace".

Mailers must also change their approach to rate regulation. Over the course of the thirty-five years since enactment of the PRA, mailers have expended hundreds of millions of dollars fighting for relative advantage. It has now become clear that relative advantage, even if achieved, will no longer protect mailers. If postal costs cannot be constrained to a level to permit continuation of quality service at affordable rates, relative advantage will become irrelevant. The Service is close to failing to achieve that goal and it is essential to institute a new era of postal regulation.

In sum, the Postal Service, pursuant to clear statutory provisions, needs to be given greater control over its people, prices and products.

We appreciate this opportunity to present MOAA's views on the vital issue of postal reform.

April 8, 2004

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