

BEFORE THE

PRESIDENT'S COMMISSION
ON THE UNITED STATES POSTAL SERVICE

TESTIMONY OF
THE AMERICAN POSTAL WORKERS UNION, AFL-CIO

(February 12, 2003)

William Burrus
President
American Postal Workers Union, AFL-CIO
1300 L Street, N.W.
Washington, D.C. 20005
(202) 842-4246

Executive Summary

February 12, 2003

Despite common perception and unsupported assertions, the Postal Service has a business model that is NOT BROKEN. In fact, it is far healthier than many large corporations. Since 1971, it has been a self-supporting, independent establishment of the executive branch. Its volume has grown in good times and fallen far less than many companies in bad times. Its major problem is to ensure that its management stays focused on the financial integrity of the Postal Service and shows less concern about the pressure for lower rates coming from its larger customers. All postal customers concerns need to be considered but not at the expense of the financial health of the organization.

The Business model is not one that requires an ever-expanding volume, although that has been the case for over 200 years and will likely continue. It does not require that rates be frozen. It does not require a host of new products or services. (The last significant new service was the creation of money orders as mandated by Congress during the Civil War.) It does not require that the Postal Service compete against E-mail, for there is no price cheap enough to make it valuable for a customer to choose mail over E-mail. It does not even require that the Postal Service lose money to placate the large mailers who influence its Governors to support excessive discounts, delay the implementation of rate increases, and put off the filing of rate case requests.

While low cost and efficient operations are important, the Postal Service already has the lowest price service of major countries. Other factors are more important than cost in its governing legislation. First among these is service to Rural and Urban America. The factors of trust, convenience, safety, security and customer satisfaction are more important than the absolute lowest cost. Available pricing flexibility has not been used and postal decisions to

delay price changes have subverted the stated goal of small predictable price increases.

Discounts have been used to unfairly subsidize large mailers at the expense of individuals and small businesses. These discounts exceed the cost saved by the Postal Service for presorted mail and far exceed the cost to the customer for the work.

The concerns regarding the cost of the growing Postal network and the alleged inability of the Postal Service to continue to financially sustain this network growth are not supported when one examines the data. As long as mail volume grows faster than delivery points, the ratio of pieces per possible delivery will not decline. This simply means that the new delivery points on average are getting as much mail as all previous delivery points did. This also means the new delivery points are bringing with them the same revenue as all other delivery points. In FY 1971 the number of pieces per possible delivery stood at 1,074 while in FY 2000 it had grown to 1,529. Despite the combined negative impact of the economic downturn, the horrors of 9/11/01, and the anthrax scare, the number stood at 1,454 in FY 2002. In FY 1997, while the Postal Service was earning significant net income/surpluses, that number was at 1,457. If that number of pieces per possible delivery allowed a net income in 1997, it should allow that same net income today – in spite of the temporary volume decline.

The Postal Service has asked for moderate legislative change. However, it already has the freedom it seeks in most areas. Its constraints are mostly self-imposed and its view of business as being uninhibited by government regulation is naive. The Postal Service has long and loudly complained about its lack of control over pricing, markets, and labor. Large companies all face similar problems and they have the added burden of taxes and class action law suits that the Postal Service does not face.

It has kept price increases to inflation for the individual and below inflation for the large customers. It started with over 20 percent of its budgets from appropriated funds, and still managed to significantly over fund its retirement plan. Postal executives deserve great credit for their pursuit of the truth about this issue over many years.

The Governors have for many years declined to ask for appropriations, still authorized, to cover the costs of the small postal facilities that it now wishes to close because it says it can't afford them.

The Postal Service has an excellent record in its operations with very dedicated people. However, its Governors have made decisions that have led to financial crises. The combined effects of 9/11, the recession and the Anthrax attacks have resulted in a two-year volume decline of only 2.5 percent. The Postal Service is not yet broken and does not need a legislative change to survive and prosper. It does need to apply good business principles.

Introduction

Many of the comments made at the formation of the President's Commission on the Postal Service are inaccurate, misleading and based on conventional wisdom that is demonstrably wrong. The charge to this Commission is about the future of the Postal Service. In determining the future, it is imperative to begin with a full understanding of the Postal Service and its problems. The fundamental problems facing the Postal Service have been caused by the Postal Service itself, and the Postal Service can solve those problems.

This paper will first attempt to deal with false assumptions that seem to underlie the Commission's formation. These include the cessation of mail volume growth, the effect of the Internet on First-class mail volume growth, the root causes of the Postal Services current financial condition, the capacity of the Postal Service to increase revenue by raising prices, the need for discounts, and the desirability for new products and services. The Postal Service is doing the public a disservice by allowing these misconceptions to continue when its own data show the true facts. This paper will also focus on public policy choices and wise business models.¹

The Postal Service has been successful:

The Postal Service has been reasonably successful in its mission. It has taken the Post Office Department from poor service and heavy subsidies to greatly improved service without subsidies. It is not yet broken and does not require a law change to return to the path of prosperity upon which it had been traveling prior to 1998.

¹ The APWU wishes to express its appreciation to Michael Riley and Harold Orenstein of Riley Associates, LLC, 9404 Starlit Ponds Drive, Fairfax, VA 22032, for their assistance in the preparation of this testimony.

The Service's major problems are the direct result of decisions of its Board of Governors and the Postal Rate Commission. In the past other Boards have made decisions that led to good finances, paying off debt, improved customer service, and investment in automation that has saved billions and improved information flow.

The Postal Service's proposals for addressing its problems are set out in its Transformation Plan. Most of the proposals in the Transformation Plan, described as needed changes, are currently available to the Postal Service. Those that involve additional authority are at best modestly positive but without the ability to significantly improve the Postal Service's financial results. Some features of the Plan, if enacted, would threaten the future existence of the Postal Service.

Exaggerated, Misleading and Overly Pessimistic Assumptions

Several reasons are advanced by the Postal Service for change to the current business model and these reasons are echoed frequently by others. They extrapolate short-term phenomena that will fix themselves or can easily be fixed into dire predictions. These include: falling volume, smaller contributions to the bottom line from non-presorted mail and an ever increasing mail delivery network that can no longer be financially supported from mail revenues. All of these dire predictions underlie the alleged need for change, and are not likely to come true in the foreseeable future if the Postal Service uses the existing tools available to it and manages the finances of the Postal Service as is required under present law.

In his remarks to the Commission on January 8, 2003, Treasury Undersecretary Peter R. Fisher said the following:

New technology, declining volume, and continued expansion of the delivery cost base, combined with competition from the private sector, pose a fundamental

*challenge to the Postal Service. You need to help us identify a new business model that will create the Postal Service for the 21st Century.*²

These basic premises are either false or subject to great debate due to the lack of hard evidence. A small and unusual volume decline in a terrible time should not overshadow a strong, long-term, steady increase. Importantly, volume has begun growing again. The lack of financial support to continue the expansion of the delivery cost base is misleading because it implies that something has fundamentally changed. Neither new technology nor competition from the private sector is a new challenge in this century much less in the last few years. In fact the case can be made that the Postal Service is winning the war for advertising. This paper will address each of these four items.

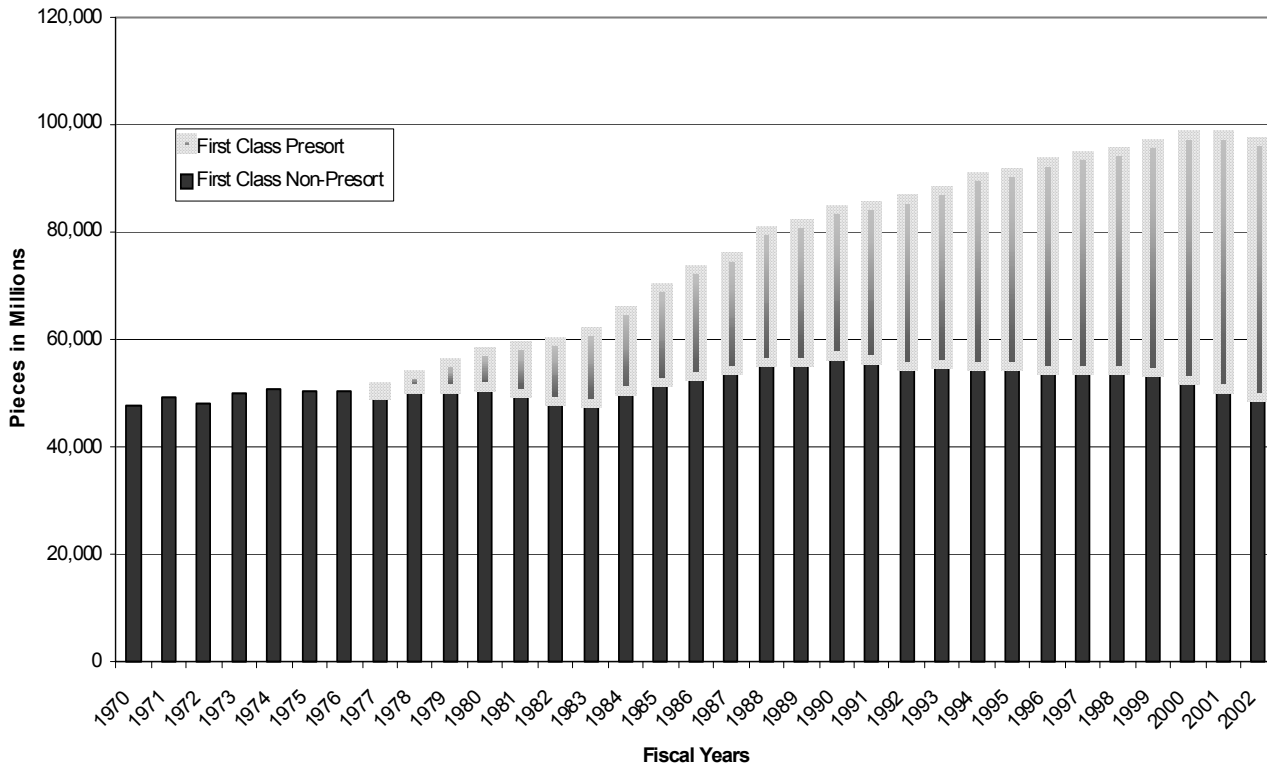
Volume has Grown not Declined: As the graph below shows, First-class mail volume has grown steadily over the past 30 years (averaging 2.24 percent) despite various elements of the electronic revolution. The basic business of delivering the mail has been only modestly affected both positively and negatively by the fax, the cell phone, overnight delivery, the Internet, cable and satellite television, and E-mail. Throughout the last three decades, total mail (which is largely letter mail and advertising mail) grew at a healthy rate averaging 2.78 percent. Total mail grew 1.5% in the first quarter of Fiscal Year 2003, which shows that the recovery is not far away. As the economy recovers, so will First-class and total mail volume. The slowing economy and the combined effects of 9/11/2001 and the anthrax in the mail scare would be expected to slow the growth of both First-class and total mail volume. The small degree to which such mail has declined during these major impacts attests not to the USPS's weakness, but to its good health. In this difficult time for business, the Postal Service has suffered far less

² From the remarks of Treasury Undersecretary Peter R. Fisher to the President's Commission on the United States Postal Service (January 8, 2003).

volume decrease than most major service industries. Airlines, hotels and even Internet advertisers have experienced dramatic declines that dwarf the 2.5% seen in Mail.

Since the creation of automation discounts for First-class mail there has been a continuous movement from single piece into lower priced discounted categories.

FIRST-CLASS LETTERS AND SEALED PARCEL VOLUME



The character of the mail has changed as individuals have replaced many letters with alternatives. But mail remains as a viable alternative for use by the public. Mail has continued to fulfill its original mission to facilitate commerce and help people start and grow their businesses. It is used for advertising because it works.

Growth in Delivery Points offset by Growth in Mail and Revenue: There is concern that for some unspecified reason, the continued growth in delivery points cannot be financed.

The implication is that the new delivery points bring no new volume and no new revenue to finance them. That implication is false.

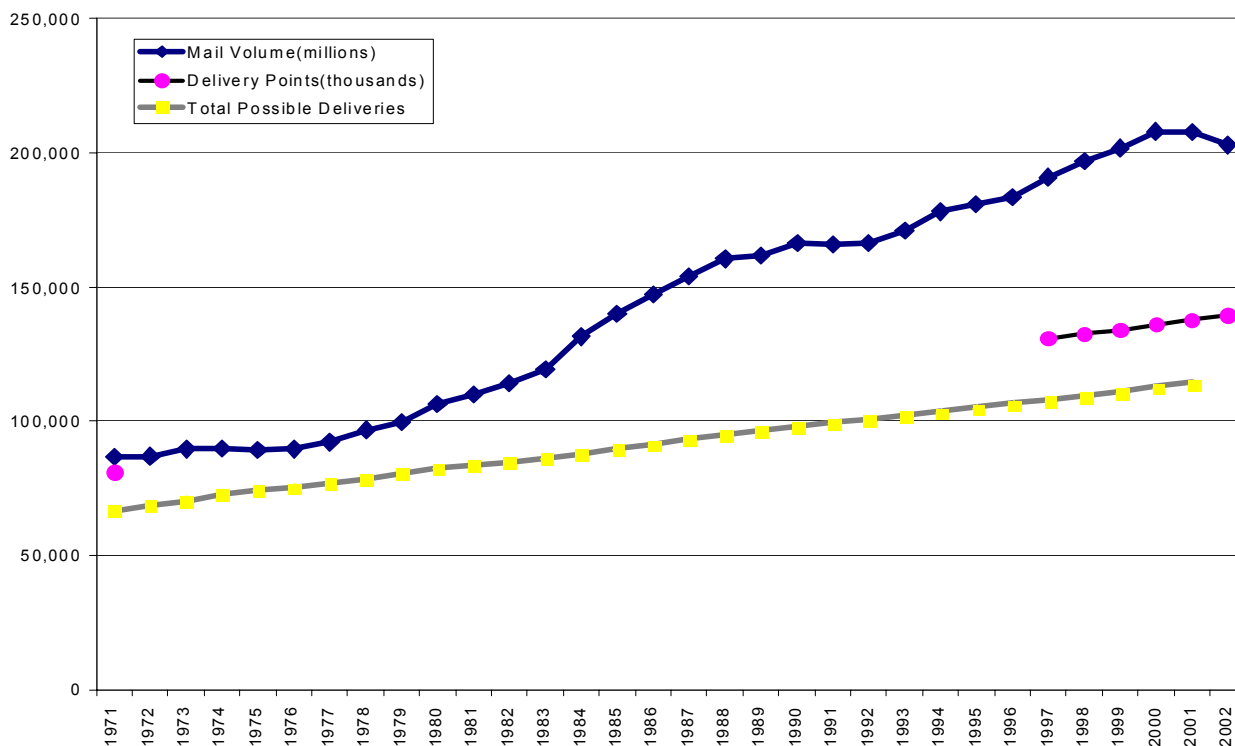
Total Delivery Point Growth has averaged 1.78 percent per year over the past 31 years and has been consistently under that rate in the past five years. In contrast mail volume growth over the same 31 years has averaged 2.78 percent per year with the understandable exception of the past two years. Mail volume growth has rarely been negative and more often exceeds two and even three percent per year. Annual mail volume growth was even accelerating over the most recent five-year period until a combination of unusual circumstances occurred. The combined impact of the 9/11/01 disaster, the anthrax in the mail scare, and a weakening economy has resulted in the rare but temporary volume decline of the recent past. Since Postal Quarter I of Fiscal Year 2002, the trend in total mail volume by Postal Quarter has consistently demonstrated strength and recovery. As stated above in Postal Quarter I of FY 2003 mail volume actually increased by 1.5 percent over the same period the previous year. It is very likely we will continue to see this growth in the future.

The relationship of mail volume to possible deliveries results in a measure referred to as pieces per possible delivery. The concerns regarding the cost of the growing Postal network and the alleged inability of the Postal Service to continue to financially sustain this network growth are not supported when one examines the data. As long as mail volume grows faster than delivery points, the ratio of pieces per possible delivery will not decline. This simply means that the new delivery points on average are getting as much mail as all previous delivery points. This also means the new delivery points are bringing with them the same revenue as all other delivery points. In FY 1971 the number of pieces per possible delivery stood at 1,074 while in FY 2000 it had grown to 1,529. Despite the combined negative impact of the economic downturn, the

horrors of 9/11/01, and the anthrax scare, the number stood at 1,454 in FY 2002. In FY 1997, while the Postal Service was earning significant net income/surpluses, that number was at 1,457. If that number of pieces per possible delivery allowed a net income in 1997, it should allow that same net income today – in spite of the temporary volume decline. Once mail volume growth overcomes the effects of the recent past, pieces per possible delivery will continue to grow. Thus the benefits of a growing delivery network will not harm the Postal Service finances in the future.

The graph below uses available data to compare the growth in delivery points and volume. We lack the series showing total delivery points except for the most recent 6 years and 1971. However, the number of total possible deliveries, which exclude Post Office Box and highway delivery points, is a reasonable substitute and is available to us. It clearly shows that new delivery points generate new mail. And since new home and new apartment construction occurs primarily in middle and upper income areas, it should be no surprise that these are very desirable targets for advertisers as well.

COMPARISON OF MAIL VOLUME GROWTH WITH DELIVERY POINT GROWTH



Neither New Technology nor Electronic Diversion will Destroy Mail Volume

Growth: Over most of the past ten years, Postal Managers have been deeply worried about the ability to survive in the new electronic world. The tradition of worrying that “the sky is falling” has persisted for over a century not just the last decade. In the 1872 report of the Postmaster General, he reported great concern about the telegraph and the invention of the fax.³ (Of course, it took over 100 years for fax technology to progress to the point where it has become an inexpensive, reasonably reliable but not a secure way to transmit documents.)

Today “everyone knows” that E-mail and the Internet will weaken or destroy the Postal Service. Yet in a horrible year, dealing with the effects of 9/11, Anthrax, and a recession; the

³ See Appendix for excerpts from 1872 Annual Report of Postmaster General Creswell

Postal Service lost only \$676 million. As a comparison, AOL Time Warner had a bad year and wrote off nearly \$100 billion, and it was not because E-mail was eroding AOL's volume.

It would be a tragic mistake to assume that the temporary decline in mail, that almost always occurs during a recession, is cause to believe that the Postal Service's business model is broken and the world has changed in such a way that mail volume will never again increase.

Looking carefully at technical data, we conclude that the allegations of electronic diversion of mail volume, while real, are not as dire as alleged. On page 3 of its Transformation Plan, the Postal Service states, "Postal Service models indicate that electronic diversion is the largest contributing factor driving the decline in First-Class Mail, single-piece letters." It cites Dr. Tolley for this claim and this is misleading to say the least. It refers to Postal Rate Commission Docket No. R-2001-1 Testimony of Dr. Tolley, page 37. Dr. Tolley explains trends over the five-year period 1996 to 2001, with 9 factors that tend to drive First-Class single piece volume both up and down. The biggest factor was an 8.9% down from "Other Factors" which appear to be the shift to discounted First-Class Mail. The remaining factors are the following: +5.1% Income, Long-run; +2.3% Own Price; +4.5% Adult Population; +3.4% Rule Change; (8.6%) Internet Service; (0.6%) Cross Pieces; and (0.3%) Income, Short-run. This reveals that the shift of First-class mail to presort/discounted from single piece played a more prominent role than the effect of Internet conversion.

Over that same time period **total First-class mail volume grew** approximately 5.5 percent and **total mail volume grew** 12 percent. Although growth has slowed for reasons that are unclear, the Postal Service still has healthy growth for a 200+ year-old institution.

The alleged loss of "contribution" to the bottom line that threatens the Postal Service's ability to maintain its network due to the reduction of Single Piece First-class letter volume is a

self inflicted wound of the Postal Service's management and it's Board of Governors. The absolute decline in Single Piece First-class mail volume has ordinarily been more than offset by the increase in automation (presort) volume with the single exception of FY 2002. Because the Postal Service insists on granting discounts for this automation (presorted) mail that are larger than the Postal Service's costs that such mail avoids, it makes sense for mailers and presort bureaus to convert non-presorted mail to automation (presort) mail. The Postal Service points to a falling "contribution" from this First-class mail as the reason the Postal Service will not be able to maintain and fund the continued growth of the postal network and its expansion is thus threatened. The solution to this problem simply requires the Postal Service to properly set its automation (presort) discounts so that the net contribution of each First- class mail piece is essentially the same whether it enters as a presort piece or as a non-presort piece.⁴

Competition from the Private Sector is not New and Will not Mean the End of the Postal Service: The Postal Service has lost the battle for parcels and overnight delivery a long time ago. Some, who are currently in top management of the Postal Service, conceived of an overnight mail delivery network many years ago. The Postal Service created Express Mail in the early 1970's only to have FED-EX take away virtually all of the business. Unfortunately, preoccupation (by the Governors of that day) with cost minimization strategies prevented the Postal Service from a successful implementation of this smart, business strategy. United Parcel Service and FED-EX have succeeded in taking away virtually all of the parcel and overnight business by using superior service, better information technology, convenience, and skillful

⁴ The volume of mail that would leave the postal system, were these higher automation rates placed into effect, would be minimal according to the Postal Service's volume expert Dr. Tolley.

marketing.⁵ The Postal Service has always focused on the strategy of using price as its only weapon in this fight.

In any case, the competition that should matter is for delivery of letter mail and advertising mail. The Postal Service has shown that it delivers at prices well below other countries and with better service than many. It has held its own in advertising while most other participants have seen their market share decline with new entrants from Telemarketing, Cable TV and Internet firms.

Current Business Model

The basic business model currently in place is one of compromises. It has some advantages and some disadvantages. The Postal Service pays no income, property or excise taxes. Its regulations and purchasing manual carry the weight of law in many cases. It is authorized to request, but chooses to not request, funds approximating \$450 million to help pay for its universal service obligation. It is required to fund the Postal Inspection Service and the Inspector General who have authority to enforce laws dealing with the mail. It has a requirement for compulsory arbitration in labor matters, something the managers of bankrupt airlines can only dream about. There is a bill in the U. S. Senate to create a Postal Service like compulsory arbitration process for airlines. The Postal Service is required to provide the mail service that Americans need regardless of whether volume increases or decreases and to fund its operations from its revenues.

This business model appears to be misunderstood. For example, Undersecretary Fisher's comments to the Commission show a lack of appreciation for the robustness of the current situation. He states:

⁵ Recently it conceded an important convenience item to FED-EX when it allowed FED-EX to put pick up boxes in prime Postal locations.

I like to think of the Postal Service as the ultimate network business, and an important value of any network is the scope of its reach. One question that the Commission might consider is how the network could be leveraged to ensure that it is operated in the most efficient manner possible and at the lowest cost.⁶

USPS has Low Prices: The U. S. Postal Service is able to price its First-class mail far below that of most other countries. This strongly suggests that the Postal Service is already very efficient. It is likely the most efficient Post in the world, public or private.

Service to the Poor in Rural and Inner Cities More Important than Cost: From its inception as the Post Office Department through the creation of the Postal Service, the goal has been to serve all people with special emphasis on the poor in both urban and rural settings. In the book, Spreading the News, Richard R. John argues that the U. S. Mail, by serving all, was a major reason for the superior economic growth and political development of the United States. He notes, “By 1828, the American postal system had almost twice as many offices as the postal system in Great Britain and over five times as many as the postal system in France.” (Both countries were much larger in population.)

In the Postal Reorganization Act, Congress explicitly reaffirms this 200 year old obligation to provide service to bind the nation together even in small towns where post offices are not self-sustaining.⁷

Trust is Greatest Asset: The Postal Service has become a trusted and well-liked arm of the U. S. Government. Trust is the greatest asset of the Postal Service. While adding to the cost, the Postal Inspection Service is a national treasure that adds immense value. The success of the Postal Inspectors has limited mail fraud to levels far below other countries. Good employees,

⁶ From the remarks of Treasury Undersecretary Peter R. Fisher to the President’s Commission on the United States Postal Service (January 8, 2003).

⁷ See the appendix for the two paragraphs, 101 (a) and (b).

who take an oath of allegiance to the Constitution, add greatly to the public's high regard for this institution. Trust lies at the heart of the public's favorable perception of the mail.

Convenience, Safety, Security, and Customer Satisfaction Very Important: In a service business, price matters but usually convenience, safety, security, service, and treatment of customers matter more. As an example, customers and employees reacted extremely well to businesslike service enhancements such as the introduction of credit and debit card acceptance at all retail locations. This change added cost, but delighted employees and customers with its added convenience.

You will need to explore the delicate balance between pricing and cost flexibilities in a monopoly business and whether the Postal Service could use additional flexibility in these areas.⁸

Available Pricing Flexibility not Used: While Regulation is at the top of the list of changes desired by the Postal Service, the Postal Service has freedom that it does not use. It has filed 12 major rates cases in the past 32 years. It could file a rate case every year or even every 10 months were that necessary. It espouses the goal of small, predictable price changes that mirror inflation. Yet, it frequently delays filing and implementing price changes. This action directly subverts the goal of small, predictable price increases as well as earning a positive net income.

The Postal Service identifies four areas in which it believes the Postal Rate Commission can accommodate its identified needs. These include: Negotiated Service Agreements, (one of which is currently being explored at the PRC), Targeted Pricing Incentives, Experimental Classifications, and Phased Rates. It should be emphasized that all of these initiatives are deemed possible by the Postal Service under existing law.

⁸ From the remarks of Treasury Undersecretary Peter R. Fisher to the President's Commission on the United States Postal Service (January 8, 2003).

Gives Discounts Beyond Costs Saved: The Postal Service asks for the ability to give discounts to attract new customers. Yet, it already gives discounts to large mailers equal to about 25% of the price that individuals and small businesses pay for first class postage. It is especially troubling that these discounts exceed the costs that the Postal Service saves in its system and that these discounts are for mail that has no alternative delivery service. The current rate setting mechanism forces single piece users to subsidize large mailers and presort bureaus. This causes the Postal Service to lose contribution on each piece that switches to excessively discounted rates. As more mail takes advantage of these excessive discounts and switches to a presort category, this hurts profitability even more.

Price has Little Effect on Volume: The Postal Service has detailed economic studies that show that letter mail volume changes very little with price changes. Even with large percentage price increases, mail volume is relatively unaffected. In economic terms this mail is price inelastic. This also means that lowering your price does nothing but lower your bottom line. Few new pieces enter the mailstream at the lower price but all other pieces in the mailstream now also generate only that lower price.

Parcel volume is much more sensitive to price. However, as we have mentioned earlier the Postal Service has studies that show that factors other than price have historically been the reason for the dominance of United Parcel Service and FED-EX. The Postal Service has a very small market share of parcels and overnight deliveries. Priority Mail, Express Mail and Package Services had combined revenue of approximately \$7.7 billion out of total revenue of \$66.5 billion in Fiscal Year 2002. The Postal Service's parcel revenue of \$7.7 billion pales in comparison to the combined revenue of \$52 billion of FED-EX and UPS. Any price reduction to attempt to grow this business would reduce an already slim margin.

The Postal Reorganization act of 1970 and subsequent legislation require the Postal Service to operate in certain ways that increase the cost of doing business and imbed inefficiencies into the operating, cost and governance structure. Examples include prohibitions, or effective prohibitions on post office or other infrastructure realignments, requirements that place financial or structural burdens that have the effect of increasing the liabilities of the Postal Service as well as a break-even mandate that eliminated the financial cushion necessary to withstand economic cycles.⁹

There is no effective prohibition on post office realignments: The 2002 Annual Report of the Postal Service shows that from 1998 to 2002 the following occurred:

- Contract Stations and branches decreased 15.9% from 2974 to 2500
- Community Post Offices decreased 5.1% from 1572 to 1492
- Post Offices decreased 0.6% from 27,952 to 27,791 despite opening new Post Offices in new towns around the country
- Classified Stations and branches **increased** 4.2% from 5,661 to 5,900.¹⁰

The Postal Service has had a process in place for some time for dealing with Post Office closings. This process explores more than just the absolute dollars saved and it has worked reasonably well. It must be understood that as a network each node is not independent and should not be viewed as a separate profit center.

The Postal Service is like a telephone network where the value to the heavy user is the access both to and from the light user. Further, since the Postal Service does enjoy a monopoly position with a significant portion of the mail, some of the responsibility for binding the nation together should influence the decisions for closing Post Offices. The Postal Service should also be aware of its responsibility as a major business, as are many other large corporations in this country who often make responsible business decisions in the best interest of their civic

⁹ From the remarks of Treasury Undersecretary Peter R. Fisher to the President's Commission on the United States Postal Service (January 8, 2003).

¹⁰ Classified stations and branches are subsidiaries of main Post Offices. Many large Post Offices have large numbers of such subsidiaries reporting to them.

responsibility. If this proves burdensome, then the Postal Service should request the Public Service Appropriation authorized for that purpose. This added cost, in some measure, offsets the advantage that the Postal Service has in its immunity from taxes. Many business people would happily make such a trade-off. This does not preclude working with the Postal Rate Commission, which has jurisdiction, to find better ways of serving the public need in a rational manner as they have in the past.

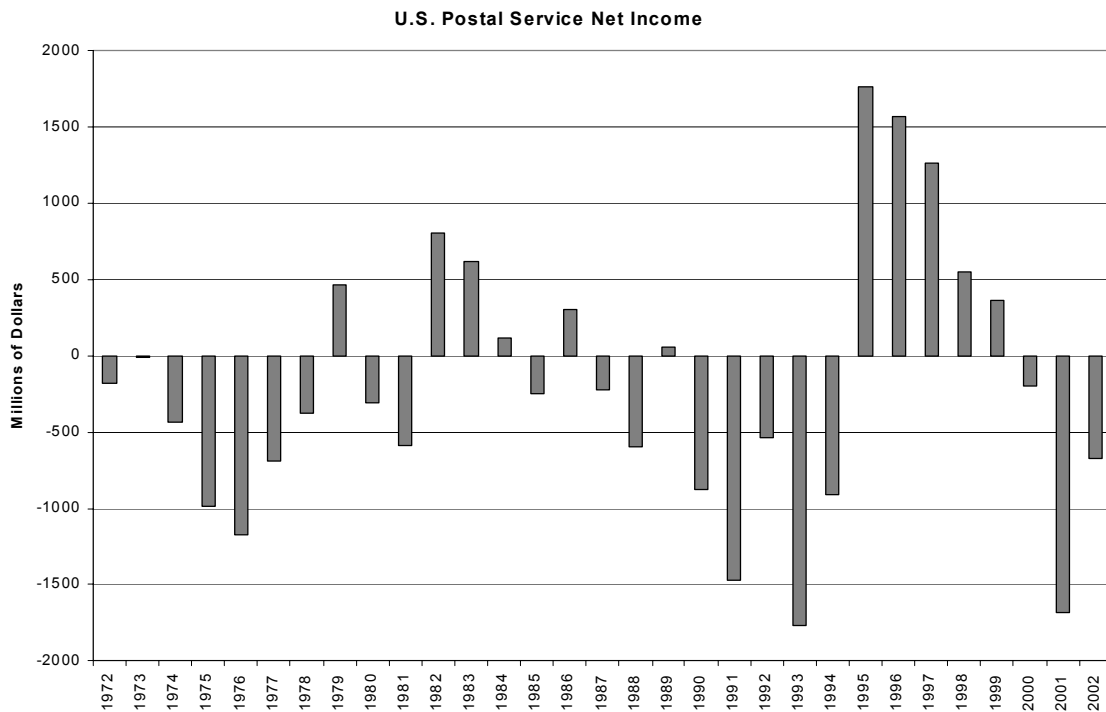
Break-Even Mandate is a Myth: The break-even mandate is widely accepted and quoted by most people in the Postal Service and the mailing community. In fact, the law has no such mandate. The requirements of the law are to set prices that allow the Postal Service to “maintain and continue the development of postal services”.¹¹ The law requires that rates and fees be set to cover all costs, including some that do not appear on an income statement as expenses, e.g. provision for sinking funds. Further, the law provides that prices cover contingencies and emergencies.¹² Finally it requires “sufficient revenues” so that the total revenue will “equal as nearly as practicable total estimated costs of the Postal Service.” Since it is not practicable for the Postal Service to do all that it is asked to do with losses, the Postal Service can and should earn profits each year. Clearly there is room to earn profits and the Postal Service has done so in a number of years.

USPS Can Earn Profits The chart below shows that the Postal Service can earn sufficient profits to provide the financial cushion necessary to withstand economic cycles. Postal Service Financial problems have arisen when the Governors delayed price increases as they did in 1998. The Board of Governors accepted a Postal Rate Commission recommendation to raise prices 2.9 percent instead of the 4.5 percent requested and then delayed the implementation for six months.

¹¹ See paragraph 3621 in Title 39, U. S. Code in the Appendix.

¹² See paragraphs 2009 and 3621.

At the same time they authorized significant spending increases at the request of management. Mailers argued that the law requires the Postal Service to “Break-Even” and that any profit was not appropriate. The Governors yielding to this pressure effectively reversed their Policy about earning profits and set the stage for large losses and the current financial crises as the debt sky-rocketed.



The Postal Service dramatically escalated spending for tangential services such as call centers that divert calls from local Post Offices. At the same time that expenses were increasing dramatically, the Governors delayed the implementation of rates from June 1998 to early 1999, they moved a needed rate case from 1999 to 2000, and filed for an amount below what was needed to cover costs. The Postal Rate Commission added to the problems by cutting the size of the contingency reserve requested by the Postal Service. The PRC recommended far less than requested in both cases; yet they now criticize the Postal Service for having insufficient reserves.

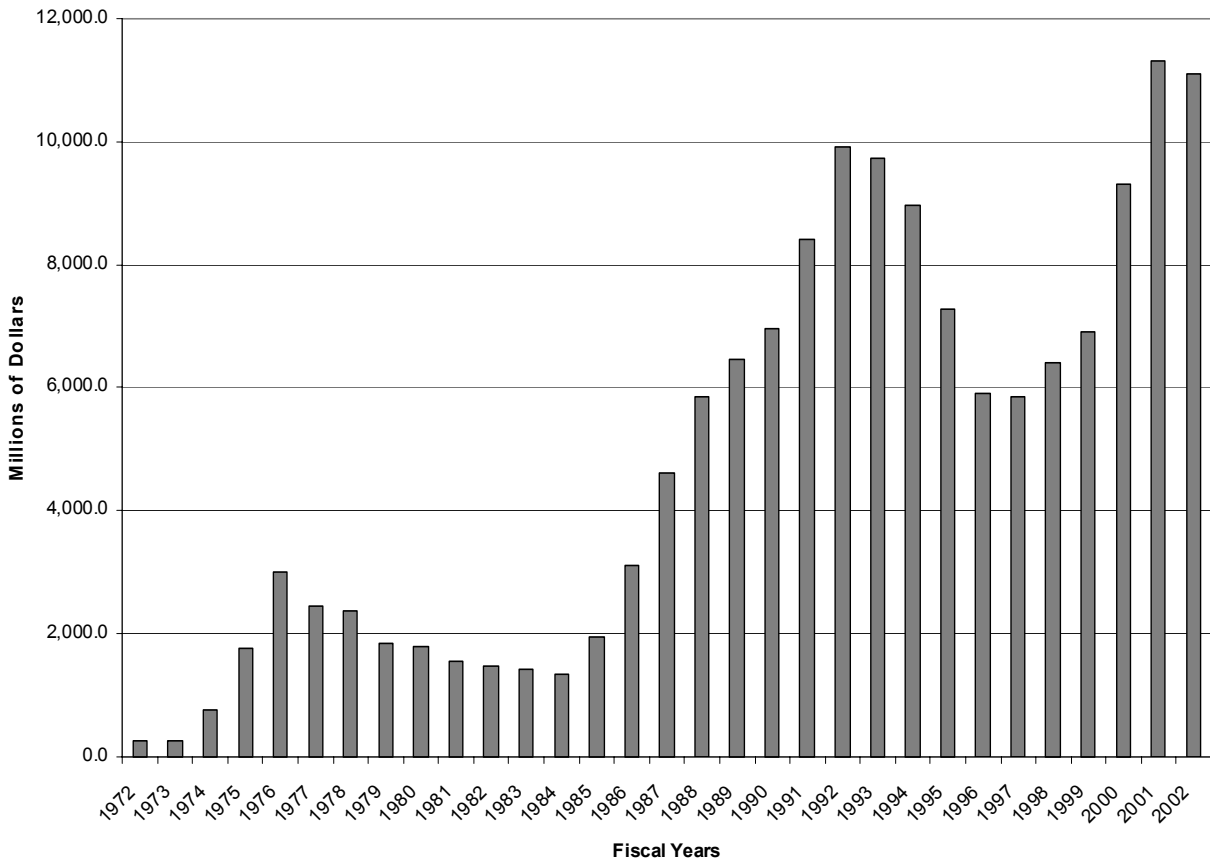
If the Postal Service had gone into 9/11/01 with the profits of 1997, it would not have faced the financial disaster that was narrowly averted by draconian cost cutting and an unprecedented, shortened, rate case hearing and recommendation.

The Postal Service, by choosing to eschew profits, eliminated its financial protection against recession and the business results of the attacks on our country. This was nearly a mortal, self-inflicted wound.

This myth of required “Break-Even” has become so widely accepted as to threaten the financial security of the Postal Service. It serves as the focus of Postal Ratemaking, although the Service requests and the Postal Rate Commission approves amounts for the recovery of prior year losses and contingencies neither of which ever appear on the Postal Service’s Profit and Loss statement. This alleged break-even requirement is often at odds with good business practice and works against the law’s mandate to maintain and continue the development of postal services.

Debt Levels Controlled by Postal Service: The Postal Service has been threatened more by its own choices than by requirements of the law. Decisions about capital spending and the timing of price increases have at times driven debt dramatically upward. At other times, policies and decisions by the Governors have allowed significant debt repayment. Putting the desire of large customers for “Break-Even” ahead of business management considerations has deprived the Postal Service of the cash needed to fund needed capital expenditures and to provide the service that the public needs and expects. Further, it has driven up borrowing to the point where the Postal Service neared its \$15 billion borrowing limit. In the past, good financial discipline has allowed periods of debt reduction as the chart below shows.

U.S. POSTAL SERVICE OUTSTANDING DEBT



The Postal Service faces a large challenge with respect to human resource productivity and incentives at all levels of the organization. With over seventy-five percent of its costs related to human resources, the Commission should explore how the Postal Service can do an even better job of providing employees the appropriate incentives for continuous improvement in productivity.¹³

Incentives have Worked: During the years from 1995 to 1998, the Postal Service achieved great success with Economic Value Added and a balanced score card that initially

¹³ From the remarks of Treasury Undersecretary Peter R. Fisher to the President’s Commission on the United States Postal Service (January 8, 2003).

included employee ratings of managers, customer satisfaction and Economic Value Added, the trademarked Stern Stewart system that encouraged wise business decisions. The system was weakened to allow bonuses with losses as the Governors succumbed to the desires of big mailers who railed against profits.

However, it is not all about costs. The revenue side is driven by a regulated pricing mechanism that is time consuming at best. You may want to consider whether current and future costs can be understood and communicated more clearly in the pricing of postal services. You could also consider whether it is possible or beneficial to introduce greater clarity and predictability into the postal rate setting process with the goal to enhance predictability and public confidence.¹⁴

Implementing rates 2 months earlier would have saved \$8 billion: Delays in the ratemaking process can be predicted and managed. Over the past 32 years, reasonable timing that produced 1 percent more revenue (and 1 percent higher prices) would have produced retained earnings in excess of \$5 billion. An extra 1 percent pales in comparison to the 362 percent increase in the price of the first class stamp over the past 32 years. Indeed, the actual price per piece for a single piece of mail would not need to be higher, only the timing of recommended and approved price changes would have to have been a month or two sooner. If each of the twelve price increases had been implemented 2 months sooner, the Postal Service would have earned nearly \$8 billion more net income and have \$2 billion in positive retained earnings.

Greater price flexibility would likely lead the Postal Service into a price war given its historical reliance on price as its primary marketing tool. **No one wins in a price war.** And the current rate-making process prevents the Postal Service from initiating a destructive price war.

¹⁴ From the remarks of Treasury Undersecretary Peter R. Fisher to the President's Commission on the United States Postal Service (January 8, 2003).

Delays are the Choice of the Postal Service: The reason for the unpredictability has been the delays in filing and in implementing rate increases. Waiting until losses threaten survival, also increases the needed percentage increase. This is the direct result of giving in to pressure rather than making decisions that recognize the fiduciary responsibility of the Governors to protect the financial integrity of the Postal Service.

Competition with the private sector is also an important issue that this Commission should examine. This may encompass new and existing postal products and services or the monopoly status of access to the individual mailbox. You will also need to explore the issue of cross subsidies.¹⁵

Unfair Subsidies Exist: Intra-class subsidies exist within First Class rates. Single piece mailers subsidize large businesses with discounts well beyond the costs actually saved by the Postal Service. Banks, utilities and credit card companies sort mail in their computers at virtually no cost to themselves and receive discounts of as much as 9 cents off the 37 cent rate. Presort bureaus collect mail from smaller businesses, commingle it, and receive similar discounts. These discounts are so large in comparison to their own costs that presort bureaus pass on the “lion’s share” to the businesses that originate the mail pieces.¹⁶ This places a burden of more than a billion dollars a year on individual mailers and small businesses.

New Products and Services have not Helped: From time to time the Postal Service and its critics suggest that new products and services will provide the solution to some ill-defined problem. It is folly to suggest that the Postal Service is powerless to develop new products under the present law. In the mid-1990s, the Postal Service actively explored over 150 new products and services. Those that were implemented were relatively insignificant. Most caused losses

¹⁵ From the remarks of Treasury Undersecretary Peter R. Fisher to the President’s Commission on the United States Postal Service (January 8, 2003).

¹⁶ Witness Gillotte, R2001-1, February 26, 2002 representing presort bureaus

and the few profitable initiatives, produced earnings so small as to be lost in the rounding of overall financial statements.

“Stick to your knitting”: Few service companies have successfully offered new services and/or products. Those that have, like accounting firms offering management advice, have proved to be problematical. Fortunately, criticism from the public and Congress caused the Postal Service to avoid the type of huge undertakings that have bankrupted some large corporations. The Postal Service has in large part been forced to heed that wise piece of business advice, “Stick to your knitting.”

*Finally, the Commission will need to explore the type of financial transparency and corporate governance that would serve the Postal Service well for the 21st century. This should include your review of the role of the Board of Governors, the role of the Postal Rate Commission, the role of Congress, the management team of the Postal Service as well as the reporting of postal finances.*¹⁷

It should be noted that the individuals on the Board of Governors have, for the most part, no prior board or management experience with organizations similar in size or complexity to the Postal Service. It is likely that none would meet the requirements of recent legislation for business, Sarbanes-Oxley, with respect to being financially knowledgeable. The Postal Service’s current management team has only one officer with experience in a large business. The Postal Rate Commission currently is structured to have five full time Commissioners. These individuals typically have had no prior experience in the senior management or the boards of very large companies or boards. Unlike other regulatory commissions, the PRC members have no training or experience to qualify them to perform their duties.

¹⁷ From the remarks of Treasury Undersecretary Peter R. Fisher to the President’s Commission on the United States Postal Service (January 8, 2003).

The caliber of this group should, at a minimum, include a knowledge and appreciation of the financial aspects of running a large business. This should include familiarity with costing and pricing of successful businesses.

Further, the Office of the Consumer Advocate should pay heed to its title and represent the consumer, not the presort bureaus and large mailers as has been the case.

The Postal Rate Commission provides an opportunity for all parties to be heard and provides a record from which it must make its recommendation to the Postal Service. Although this process is time consuming and costly to all interested parties, it provides for issues to be thoroughly aired and recorded in a legal, reviewable record. One current disadvantage is that the consumer, individuals, and small business interests are not heard and are not represented by the Office of the Consumer Advocate established for this purpose.

The Postal Service is NOT BROKEN

The Postal Service has a business model that is NOT BROKEN. In fact, it is far healthier than many large corporations. Since 1971, it has been a self-supporting, independent establishment of the executive branch. Its volume has grown in good times and fallen far less than many companies in bad times. Its major problem is to ensure that its management stays focused on the financial integrity of the Postal Service and be less concerned about the pressure coming from its larger customers. All customers concerns need to be considered but not at the expense of the financial health of the organization.

Appropriated Funds: When it was founded, it had over 20% of its budget come from appropriated funds. A major part of these appropriated funds were to reimburse the Postal Service for charging preferential rates to non-profit organizations and certain publications. These, in effect, were subsidies provided to these organizations at the request of the Congress

and were simply reimbursements to the Postal Service for the difference it would have received if there were no reduced rates. The remainder of the subsidy amounting to some \$900 million was to finance the universal service commitment. Over the years, the Postal Service assumed responsibility for paying for universal service and stopped requesting appropriations to fund this mandate. The PRA still allows for approximately \$450 million, were the Postal Service wanting to request these funds.

Inflation: It has raised prices paid by individuals equal to overall inflation and less than service sector inflation. At the same time it favored large mailers with discounts and price increases far below inflation and below levels justified by cost savings to the Postal Service. Even with appropriately sized discounts, the large mailers would still have had price increases well below inflation. Its accumulated deficit of \$6 billion is less than ½ of 1 percent of its \$1+ trillion in revenues over the period. And, this deficit is the direct result of decisions by the Board of Governors to delay filing for and implementing price increases.

Some mailers have complained that with the productivity improvements from its automation program, price increases should have been less than inflation over the existence of the Postal Service. In this regard that the Postal Service has done well compared to UPS and FED-EX over the past 10 years. The Producer Price Index for ground couriers shows that, from December 1992 to December 2002 rates went up 44%. During that same period postal rates went up only 29%. Furthermore, FedEx raised shipping another 3.9 percent effective January 6, 2003.

Over Funded Retirement Plan: Recent reports have shown that unless current law is changed, the Postal Service will overfund its CSRS pension obligation by \$70 to \$100 billion.

This amount would be in excess of 6% of total revenue since 1971 and far exceeds the accumulated deficit since reorganization. Congress is considering legislation that would correct the problem and save the Postal Service more than \$5 billion in the next two years.

It Can Function Well: Experience has shown that the Postal Service can function well and earn consistent profits. In the period from 1982 to 1984 and again from 1995 to 1999, the Postal Service earned profits and used the money to maintain and continue the development of postal services as required by the law.

This included improving service to its customers. Customer Satisfaction improved with the improvement in financial condition. Long needed improvements to plant and equipment were begun using the cash from net income. The debt was reduced by \$4 billion.

It is worth noting that the American people are the real customers of the Postal Service. Big mailers make choices based on what works with people. Presort houses sort mail for mailers and serve as intermediaries. The Postal Service and the PRC seem to confuse presort houses with postal customers.

Economies Of Scale: The Postal Service delivers mail six days each week and does it for an average price of a little more than 30 cents per piece. Package delivery services, e.g. FED-EX and UPS, deliver other items for a price per piece in excess of \$4.00. The business model allows great economies of scale and economies of scope because of universal service and huge volume to a regularized network of delivery points each day.

Financial: Prices are well below those of other countries and the size of the United States and the Postal Service network is larger than most.

The Postal Service has been able to finance much of its capital spending because its customers pay in advance for postage and it collects in advance for expenses, such as workers compensation, to be paid in the future.

The Postal Service has four legal advantages: it is the only organization that can put anything into a mailbox, it has the exclusive right to deliver letters, it pays no tax and it has immunity from most lawsuits.

It has obligations to charge uniform prices to all, keep open Post Offices in remote locations, and deliver mail even when it is not profitable to do so. Like any network, there is value to the ability to reach any individual even if you choose not to do so. This negates the argument that customers in rich suburbs unfairly pay costs belonging to poor customers in urban or rural locations.

The Business model is not one that requires an ever-expanding volume, although that has been the case for over 200 years and will likely continue. It does not require that rates be frozen. It does not require a host of new products or services. (The last significant new service was the creation of money orders as mandated by Congress during the Civil War.) It does not require that the Postal Service compete against E-mail, for there is no price cheap enough to make it valuable for a customer to choose mail over E-mail. It does not even require that the Postal Service loose money to placate the lobbyists that wander its halls and influence its Governors regarding discounts, delaying the implementation of rate increases, and putting off the filing of rate case requests.

The model is one in which the Postal Service is to charge prices that allow it to provide service 6 days each week to all Americans and maintain and continue the development of Postal

Services. There does not appear to be any reason to believe that it cannot do just that, currently, and with a profit.

Postal Service Seeks Moderate Regulatory and Legislative Reforms.

The Postal Service appears to believe that ultimately it will need some moderate regulatory reforms. Certainly, it is necessary for the Postal Service to earn a positive net income, and build positive retained earnings. Since technological change might ultimately prove to be a problem in the distant future, it would be prudent to pay off its debt and provide for future obligations. However, the Postal Service can do all of these without changing the law. It takes only the courage and foresight to plan to accomplish these goals. While it is possible that a change in the law might reduce some of the lobbying efforts advocating losses, it should not be necessary.

Seek the Maximum Flexibility Consistent with the Current Rate-Making Process:

Changes to speed the implementation of new rates may be beneficial, but the Postal Service has not used the flexibility that it has. It has applied discounts in a manner that has harmed its financial position and regularly contradicts its own expert analysis with naive comments about gaining financial health through more discounting. Flexibility cannot overcome a tendency to pander to presort bureaus and big mailers at the expense of prudent business decisions. Certainly its competitors in the parcel business have not been shy (or even subject to influence by lobbyists) in raising prices yearly. They seem to understand that lowering price reduces their bottom line. No one wins a price war.

Rationalize Retail Network Facilities: The Postal Service needs to continue its earlier work with the Postal Rate Commission to find efficient ways to accommodate the needs of all its customers with proper consideration to its network of delivery points and mail entry points. Cost

is only one factor and should be considered along with the other considerations contained in the Postal Reorganization Act.

Modernize Purchasing Procedures: Purchasing is an area where the Postal Service already has freedom beyond most government agencies. It has developed a professional staff that has numerous accomplishments and an excellent reputation. Despite structural annoyances in its constraints, Purchasing has, by all measures, done an excellent job for the Postal Service. The Postal Service has no constraints about accepting the lowest bid. It is however subject to certain constraints designed by Congress to achieve public policy goals. These add complexity and some additional cost. In any case, changes to the purchasing law are unlikely to make any meaningful financial difference.

Reform Labor and Employment Provisions: The Postal Service has stated that it would prefer that its labor relations be governed by the Railway Labor Act, instead of Chapter 12 of the Postal Reorganization Act. The APWU opposes amendment of the labor provisions of the Postal Reorganization Act. Application of the Railway Labor Act to the Postal Service would be tantamount to the elimination of free collective bargaining. Under the Railway Labor Act, where a labor dispute threatens to disrupt an essential service, the dispute is placed before a presidential emergency board. This would inevitably happen whenever postal unions and management failed to reach agreement. The dispute would be dumped in the lap of the President and Congress. No strike would be permitted. Postal management could simply abdicate its collective bargaining responsibility.

We also observe that neither the railroad industry nor the airline industry is a model of business success. Industries covered by the Railway Labor Act have been having substantial

trouble in labor relations. So much so, that bills have been introduced in Congress to amend the Railway Labor Act to provide for mandatory arbitration.

New Products: The Postal Service is not configured to sell or produce merchandise nor is it amenable to offering services such as consulting that have been offered by other countries' Posts. Any new products should build on its traditional strengths which include Trust and Convenience. The Postal Service can offer new services, but it has been difficult to find any that have been significant. Care must be taken to avoid getting carried away with the latest trends.

Postal Problems were the Direct Result of Its Decisions

The Postal Service cites the GAO observation that there had been losses for three straight years and volume declines over the past eighteen months as questioning the current business model. The losses are clearly the result of the Postal Service's delaying a rate request far longer than sound business practice would dictate. The Postal Service was anticipating net income below that which the Postal Service had requested and the Rate Commission had recommended for recovering prior years losses. Had a rate request been filed in FY 1998 rather than waiting till FY 2000 and had the Postal Service not delayed implementation of R97-1 rates, the problem would not have occurred.

Postal problems have not been caused by massive diversion of advertising and letter mail to electronic transmission. It has suffered small volume decreases during recessions, but mail volume grew steadily from 87 billion pieces to 203 billion pieces during its 32-year existence.

Net Income and Retained Earnings: Financial problems have been the result of decisions by the Board of Governors of the Postal Service. They have declined to request an appropriation for the cost of universal service to cover rural and inner city areas. They have delayed needed price increases causing profits to become losses. This creates a need for larger

price increases to erase the self-inflicted large losses. They have failed to plan for financial emergencies with adequate contingencies in rates and fees as permitted by the law. There has been no recognition that consistent profits provide the contingency funds for emergencies. The result has been periodic financial crises that have led to dramatic cuts in capital spending thereby delaying economic and service related investments.

After 2 Centuries Still Twelfth Largest Company in the U. S.: Despite these decisions, the Postal Service has a business model that still works. Its customers need it and trust it. It is number 12 in revenue on the list of large companies headquartered in the United States in 2001.

The Postal Service needs better planning and better decisions about when to change prices. However, it has accumulated a deficit of \$6 billion, less than 1% of its revenue during its existence.

Finally, it should be noted that the Postal Service moved from an era in which over 20 percent of its budget was a subsidy from the federal government to the position of being completely self-sufficient.

Conclusion

The basic assumptions behind the charge to this Presidential Commission are inaccurate, misleading and based on conventional wisdom that is wrong. The Postal Service has been successful. Its major problems have been the result of its Governors giving in to the mailing industry at the expense of the Postal Service and the American public. Most of the desired changes offer minor benefit and are mostly available to the Postal Service without a change in the law.

Rather than needing a change in its business model to survive, the Postal Service should be proud of its long-term success and take the advice of that anonymous business sage, “If it ain’t broke, don’t fix it.” The Business Model of the Postal Service is not broken.

Appendix

Title 39

Sec. 101. – Postal policy

(a) The United States Postal Service shall be operated as a basic and fundamental service provided to the people by the Government of the United States, authorized by the Constitution, created by Act of Congress, and supported by the people. *The Postal 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. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities.* The costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.

(b) *The Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining. No small post office shall be closed solely for operating at a deficit, it being the specific intent of the Congress that effective postal services be insured to residents of both urban and rural communities.* [Emphasis added]

Title 39

Sec. 2009. - Annual budget

The Postal Service shall cause to be prepared annually a budget program which shall be submitted to the Office of Management and Budget, under such rules and regulations as the President may establish as to the date of submission, the form and content, the classifications of data, and the manner in which such budget program shall be prepared and presented. *The budget program shall be a business-type budget, or plan of operations, with due allowance given to the need for flexibility, including provision for emergencies and contingencies, in order that the Postal Service may properly carry out its activities as authorized by law.* The budget program shall contain estimates of the financial condition and operations of the Postal Service for the current and ensuing fiscal years and the actual condition and results of operation for the last completed fiscal year. Such budget program shall include a statement of financial condition, a statement of income and expense, an analysis of surplus or deficit, a statement of sources and application of funds, and such other supplementary statements and information as are necessary or desirable to make known the financial condition and operations of the Postal Service. Such statements shall include estimates of operations by major types of activities, together with estimates of administrative expenses and estimates of borrowings. The budget program shall also include separate statements of the amounts which the Postal Service requests to be appropriated

under subsections (b) and (c) of section [2401](#) of this title. The President shall include these amounts, with his recommendations but without revision, in the budget transmitted to Congress under section [1105](#) of title [31](#) [Emphasis added]

Title 39

Sec. 3621. - Authority to fix rates and classes

Except as otherwise provided, the Governors are authorized to establish reasonable and equitable classes of mail and reasonable and equitable rates of postage and fees for postal services in accordance with the provisions of this chapter. **Postal rates and fees shall be reasonable and equitable and sufficient to enable the Postal Service under honest, efficient, and economical management to maintain and continue the development of postal services of the kind and quality adapted to the needs of the United States. Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service. For purposes of this section, "total estimated costs" shall include (without limitation) operating expenses, depreciation on capital facilities and equipment, debt service (including interest, amortization of debt discount and expense, and provision for sinking funds or other retirements of obligations to the extent that such provision exceeds applicable depreciation charges), and a reasonable provision for contingencies.** [Emphasis added]

Title 39

Sec. 3622. - Rates and fees

(a) From time to time the Postal Service shall request the Postal Rate Commission to submit a recommended decision on changes in a rate or rates of postage or in a fee or fees for postal services if the Postal Service determines that such changes would be in the public interest and in accordance with the policies of this title. The Postal Service may submit such suggestions for rate adjustments as it deems suitable.

(b) Upon receiving a request, the Commission shall make a recommended decision on the request for changes in rates or fees in each class of mail or type of service in accordance with the policies of this title and the following factors:

- (1) the establishment and maintenance of a fair and equitable schedule;
- (2) the value of the mail service actually provided each class or type of mail service to both the sender and the recipient, including but not limited to the collection, mode of transportation, and priority of delivery;
- (3) the requirement that each class of mail or type of mail service bear the direct and indirect postal costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to such class or type;

(4) the effect of rate increases upon the general public, business mail users, and enterprises in the private sector of the economy engaged in the delivery of mail matter other than letters;

(5) the available alternative means of sending and receiving letters and other mail matter at reasonable costs;

(6) the degree of preparation of mail for delivery into the postal system performed by the mailer and its effect upon reducing costs to the Postal Service;

(7) simplicity of structure for the entire schedule and simple, identifiable relationships between the rates or fees charged the various classes of mail for postal services;

(8) the educational, cultural, scientific, and informational value to the recipient of mail matter; and

(9) such other factors as the Commission deems appropriate.

(c) Regular rates for each class or subclass of mail that includes 1 or more special rate categories for mail under former section [4358](#) (d) or (e), [4452](#) (b) or (c), or [4554](#) (b) or (c) of this title shall be established by applying the policies of this title, including the factors of section [3622](#)(b) of this title, to the costs attributable to the regular rate mail in each class or subclass combined with the mail in the corresponding special rate categories authorized by former section [4358](#) (d) or (e), [4452](#) (b) or (c), or [4554](#) (b) or (c) of this title.

(d) Compliance with any provision of the Occupational Safety and Health Act of 1970 ([29](#) U.S.C. [651](#) et seq.) shall not be considered by the Commission in determining whether to increase rates and shall not otherwise affect the service of the Postal Service

Annual Report of the Postmaster General
of The United States
1872

Pages 29 & 30

“But improvements in telegraphy render it by no means certain that in future the telegraph will not to a very great extent supersede the mail as a means of correspondence. The introduction of the duplex transmitter, doubling the capacity of lines for through business, and of the ‘Fast’ or automatic system, by which one wire can be made to do the work of six; **the probable simplification of the facsimile system of Caselli, by which an exact copy of anything that can be drawn or written may be instantaneously made to appear at a distance of hundreds of miles from the original; and the countless other applications of electricity to the transmission of intelligence yet to be made,- must sooner or later interfere most seriously with the transportation of letters by the slower means of the post.**”

Jno. A. J. Creswell
Postmaster General

Post Office Department
Washington, D. C.,
November 15, 1872
[Emphasis added]