

Speech to Direct Mail Marketers
May 10, 1994
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Good afternoon. As the new chairman of the Postal Rate Commission I am pleased to meet all of you--to renew some old acquaintances and begin what I hope will be a pleasant and informative association during my tenure in office. It always strikes me as ironic that one of the first tasks of an appointed government official is to address interest groups or constituents of his agency, most of whom have far more knowledge of the subject matter than does the official. I suppose the audience tries to read the tea leaves for potential changes, new directions, and new perspectives on old problems.

In my case I can report immediately that my 17 years on Capitol Hill, some 14 of them dealing directly with Postal Service issues, colors my analysis and impacts on what I see as priorities for both the Postal Rate Commission and the Postal Service. I believe our top priority is a strong, viable Postal Service that provides quality service at fair and equitable rates--a view I'm sure I share with you.

At the same time I confess to being bombarded with so many new issues since arriving at the Commission that it would be inappropriate for me to give you any overviews or new directions at this time. I am still on a steep learning curve--one which I hope will not become a slippery slope.

I know from his Direct Marketing News column for March '94, that Dick Barton has high expectations--how did he put it-- "that I will be comfortable with the byzantine esoteric of a postal rate case", because as he noted, I was coauthor of a paper many moons ago entitled "Modification of Erythrocyte Membrane Acetylcholinesterase by Fluorinated Dinitrobenzene".

Now most of you think Dick was just being cute with this comment. What you don't appreciate is that Dick did his homework--as he always does--before reaching that conclusion. He obtained a copy of the article from the National Library of Medicine and after reading it, realized that it dealt with "elasticity"--albeit of red blood cell membranes--but elasticity none-the-less; which is, of course, a concept of great importance to postal ratemaking.

There are, however, several matters that have repeatedly come to my attention during my two-and-a-half months at the PRC that may be of direct interest to you: 1) the underlying meaning and import of the Bulk Small Parcel Service, or BSPS, case; 2) the future of the Postal Service as assessed by looking at volume trends and the impact of technology, and 3) the possibility--at times threats from some in the mailers' community--of legislation in Congress to correct perceived inequities in the review and regulatory process that now governs the Postal Service. I know just enough about the first two that I will probably get in trouble by talking about them.

Those of you who know me know, though, that that's never stopped me before--so--

Let me start with the BSPS case, which, I understand, is viewed throughout the Postal community as an indication that the Commission has a negative attitude toward reclassification. In light of this, I have gone back and reviewed some of the BSPS decision and tried to analyze questions being raised about reclassification. I must say, I do not agree that the Commission seemed to oppose reclassification, AND I can tell you that I have no prejudice against reclassification.

I believe that facing the future effectively will almost certainly require changes, and I understand that competition is a strong force that needs to be recognized. At the same time, I also understand that there are good reasons to require that changes in rates and classifications are based on a public record and that a wide range of interests receive attention. In addition, I understand the costs of developing such a record and the demands made on the parties involved.

Over the years parcel post, as a classification, has not been neglected. Intra-BMC parcels were separated from inter-BMC parcels in the R80-1 case and, at that time, a surcharge of 50 cents for non-machineable parcels was implemented. The Postal Service did not propose changes in parcel post in either R84-1 or R87-1

The Commission's recommendations in these cases were in line with Postal Service proposals and, excepting the BSPS case, the only Postal Service proposal rejected since 1979 was an experimental case filed in 1986. That case, unfortunately, was filed at a time when parcel post was operating below cost and the Commission's options were very limited.

Nevertheless, the Governors responded to the 1986 rejection by arguing that the Commission should have offered an alternative, which is exactly what the Commission did in BSPS. This time, however, the Governors wanted only an up or a down!

When it filed the BSPS case in 1992, the Postal Service could have proposed to de-average parcel post further, and it could have proposed that separate rates should be arranged for the existing bulk parcel post category.

Rather, BSPS was filed as an entirely new class of mail. Strangely, as the Commission was to learn during rebuttal testimony, this may have been due, in part, to the fact that some of the Postal Service's experts were unaware of the very existence of the bulk parcel category. But the central problem was that the Postal Service proposed not just to separate a certain group of parcels from parcel post. It also sought to price that group at a level which seemed for all intents and purposes far below both existing and market rates.

This raised questions that even today are difficult to answer. The Postal Service argued that BSPS was part of a larger reclassification scheme, but they never let the Rate Commission in on the rest of the scheme. If they had, it might have been easier to deal with some of the questions in the case.

For example, the Postal Service proposed a five-pound weight limit for BSPS. It presented no evidence that there is a division in the market at five pounds, and it gave no evidence that mail processing equipment has a five-pound limit.

In short, no evidence was provided that the five-pound limit was non-discriminatory.

Instead the Postal Service argued that BSPS was "unique" and did not "fit" into existing parcel post--that there was an "unmet" need. Why was it unique, why didn't it fit, what was the unmet need? Its content was the same as parcel post; its processing was the same as parcel post; its service was the same as parcel post, and many of its users would have been the same.

But the real issue was rates--were they too high? R90-1 allowed parcel post a mark-up over costs of 11 percent. The R90-1 rates have proven attractive, so attractive that parcel post grew 19 percent in FY 1992, 13 percent in FY 1993, and, thus far in 1994, is growing at the rate of 26 percent. On its face, this success does not suggest a need for radical rate reductions.

Finally, let's look at the most far-fetched assumption of the Postal Service in the whole BSPS proposal--that parcel post would continue to recover its costs after BSPS was established. The Postal Service offered no evidence to support this assumption. A more plausible assumption is that these small parcels would be the lowest cost parcels in parcel post. Consequently, to remove them from parcel post may well have rendered service for the non-qualifying parcels below cost and potentially uneconomic. BSPS might have been the death knell for parcel post! With no evidence to the contrary, and no attempt to assess the impact of this result, there is a strong likelihood that BSPS, as proposed, would have been found illegal in the courts.

In light of all of the above, the Postal Rate Commission made a recommendation that preserved many of the classification characteristics of BSPS as proposed, yet gave the Postal Service something to build on, with discounts that would more accurately reflect the value of the worksharing by mailers. Further, there was promise of future rate adjustments, if justified by actual experience.

Since the PRC's BSPS recommendation, no one seems happy, particularly those who would have benefitted from the proposed lower rates. I can understand this. Who wouldn't be upset at the missed opportunity to mail at rates substantially lower than those now being paid!

It seems to me that too many observers are failing--perhaps--intentionally--to acknowledge that the case, as filed, had a long list of weaknesses and, that the weaknesses ran from policy and procedural issues all the way down to detailed questions on costs and demand.

Does BSPS mean the Rate Commission will oppose reclassification? I think not!

If the Postal Service provides the necessary documentation, explains why a proposal is rational, and then addresses its impact on all segments of the mailing public, there is no reason to believe that reclassification will meet the same fate as BSPS. The burden, however, to present a solid, well-documented case rests with the Postal Service. And, in this regard, I will tell you that off-the-record discussions I have had with knowledgeable Postal Officials and some of the most vocal critics of the Commission's BSPS recommendation confirm that the BSPS was not such a case. In fact, I find myself wondering if the Postal Service listened to its rate design experts when it developed the BSPS case.

Nevertheless, I can assure you that we will receive all of the Service's requests with an open mind.

Now, let me turn to the second topic that has been receiving considerable attention: What does the future hold for the Postal Service in the face of modern technology?

Some in the Postal Service community, particularly those who testified before the House Post Office and Civil Service Committee in April, believe the Service is near the precipice and will soon lose substantial volume to the many competitive, high-tech forms of communication.

One of my very good and longtime friends in the business mailers' community says that the Postal Service is in a race with technology that it is going to lose, ultimately. I am not about to suggest to you that this is an unlikely scenario.

Statements as to the inevitability of this result can be found as far back as the 1977 Report of the Commission on Postal Service and in testimony before then Chairman Jim Hanley's Post Office and Civil Service Committee that same year. Rumors of the Postal Service's demise, however, may not be nearly so premature in 1994 as they were in 1977. And let me be so bold as to suggest that advancing technology holds serious implications for one of the basic tenets of postal ratemaking-- that historical trends and rate elasticities are reliable indicators of future volumes.

Before looking forward, let's look back and gauge where we are relative to the recent past. Since 1970 overall First Class volume has grown at an average rate of 2.7 percent annually. Volume growth was only 1.5 percent in FY 1993, but thus far in FY 1994 the growth rate is 2.7 percent, right on the 20-year average. So, total First Class volume seems to have weathered the storm nicely.

Within First Class, presort volume growth is a very healthy 8 percent for the first two quarters of FY 1994, although single piece volume is flat to declining. This pattern has been with us since 1991, and it seems to confirm that electronic communications are replacing some First Class volume. Fax, electronic data transfers and E-mail primarily affect nonbulk, business-to-business mail. I've heard figures to the effect of 30 percent diversion from hardcopy for this type of communication.

Let us look at Third Class regular volume. Historically, and one can assume even in the near future, Third Class volume has been and will be closely associated with total, nationwide advertising expenditures. Among the competition for advertising dollars, the Postal Service has done exceedingly well. While recently, total advertising dollars have not been robust because of the 1991-1992 recession, advertising expenditures have now turned upward AND Third Class bulk regular volume has reflected that upturn. Provided the Postal Service keeps its costs in line with inflation, bulk regular volumes should grow in line with the growth of advertising expenditures.

There will be some alternative competition--catalogs will test the merits of moving along the electronic super highway--but the technical development needed nationwide for that to be viable is still a bit far off on the horizon.

For the intermediate term--five to seven years out--I think the greatest threat to postal volumes is the Postal Service itself. Costs must come into control or all mailers will actively seek alternatives to the mail.

As it now stands, First Class still pays most of the Postal Service's overhead. For years there have been threats that alternative delivery of Third Class will bring down the Service, but in actuality it now seems that First Class could be the first to leave.

First class business-to-household and vice versa may, in the face of electronic funds transfer, electronic banking and bill paying technological advances, be as sensitive to price pressure--even more so--than Second or Third Classes. A significant diversion of First Class, of course, would have a major impact on Third Class rates--much more so, given the relative contributions to overhead, than would a diversion of Third Class on First Class rates.

The fundamental problem is the common costs of the system which are about 33 percent of total costs. They are largely comparable to what we call institutional costs.

If volume falls, the Postal Service should be able to shed volume variable costs (roughly what we call attributable costs). The common costs will remain and so unit per piece costs will rise. If management fails to reduce volume variable costs, unit costs will rise precipitously.

If costs rise only because fixed common costs must be shared by fewer pieces, however, that rise should be manageable. Other industrialized countries have substantially less volume per capita than does the United States, while most of these countries have unit costs less than twice ours. Thus, smaller volumes mean higher unit operating expenses, but that does not mean that smaller volumes need to be fatal to the Postal Service as we now know it and to ratepayers. The key is the ability to contain and shed variable costs.

Ratepayers, however, are only one of the three major groups that have a stake in the Postal Service. The others--postal labor and the government--have other interests.

If volume declines and the workforce is not cut, U.S. unit costs could go from being the lowest to being among the highest in the industrialized world.

As for the government, the owner of this system, insofar as the Service has debts and future obligations, the Service may not realistically be in a position to honor all of them, if it faces large volume declines. The taxpayer may have to pick up the obligations. Thus, postal equity and its future obligations should be monitored to ensure that taxpayers are not put at risk.

What should the Postal Service do? Should it pursue new businesses and participate in the electronic highway? Who will supply the capital? If working capital is used, the monopoly ratepayer supplies the capital; if debt is used, the government will be the implicit obligator--although mailers pay the debt service.

Would this investment of capital make money? It's not altogether clear that the Postal Service could succeed, even if unregulated, in a highly competitive environment. If it did succeed, a billion in profit would impact current rates by only 2 percent a year.

What about the workforce? Modern electronic communications are not labor intensive, and current postal workers likely would enjoy few job opportunities in the new electronic ventures.

And the government? If successful, electronic profits would help the government. (Perhaps become another source of revenue for a deficit minded Congress?) Conversely, if unsuccessful, taxpayers would face additions to the deficit.

What one CAN conclude is that the Postal Service, unlike private corporations, has stakeholders, not shareholders. A private corporation diversifies and expands to protect and enhance the value of its shares of stock. Since the Postal Service has no shareholders, that rationale for business diversification would seem to make little sense.

Aside from these considerations, there are obstacles to successful postal diversification. Its management does not appear to be entrepreneurial. It has no real fund of risk capital. Its basic business is regulated. It is not clear it has the legal authority to purchase existing businesses or enter new markets. Finally, U.S. government tradition frowns on government competition with the commercial sector, outside of traditional postal service (and electric power generation). Thus, there may be no real reason for the Postal Service to seek business opportunities much beyond the margins of its traditional business.

Which brings me to my final topic--the legislative fix!

I've heard threats, mainly in connection with the Commission's failure to give adequate weight to USPS-mailer cooperation in developing the BSPS case,--that if the PRC doesn't get it right this time, there will be a concerted effort to clip its wings through some type of legislation.

Aside from the fact the level of prefiling cooperation is not a decision criterion, a quick review of Postal Service and mailing interest successes on Capitol Hill over the last decade or so is just that--QUICK! There have not been many wins. "Why is that?" you might ask yourselves. I can tell you that it's not that you haven't tried OR that you don't have really good representation. So, what is it then? Perhaps it's the subject matter!

Back in the late Seventies, Congressman Udall was testifying before the House Government Operations Committee on the Carter Executive Reorganization Plan. When asked about his experience with Postal Reorganization, Udall offered that, while he is frequently referred to as its father, he wanted to take the opportunity, publicly, to deny paternity. He then added that, although the Postal Reorganization Act had passed both houses of Congress by overwhelming majorities, he had difficulty finding anyone who would fess up to having voted for it.

When Udall spoke, there were a good many Members still in Congress who were there in the summer of 1970. Next year there will be no more than 19 House Members and 10 Senators remaining--and not all of them voted, or voted in favor of-- passage of the Postal Reorganization Act.

The Congress of today is not the Congress that voted for Postal Reorganization. What it knows about the Postal Service it knows from what it sees--what it hears on the news and what it hears from its constituents. How bad is the situation--customer satisfaction indices not with standing?

Well, while I don't think it is at all fair, one of the battle cries of those who oppose a larger role for the government in health care reform is "it will have the compassion of IRS AND the efficiency of the Postal Service." Do you think, given the atmosphere of the day, that Congress is prepared to give the Service freer reign on rates or to allow it to venture into new, unregulated arenas?

In closing, let me tell you what I learned about the legislative process in all those years I worked on Capitol Hill. One of the truths I've learned is "never say never"; another is that once you open Pandora's box, you never quite know what is going to come flying out.

Perhaps it is best that we work and reason together to ensure a strong, viable Postal Service!

THANK YOU!