

Remarks of  
The Honorable Edward J. Gleiman, Chairman  
United States Postal Rate Commission  
Before the  
National Postal Policy Council

December 4, 1996

When Mike Cavanagh asked me to speak to you about the future of the Postal Service on this, the 15th anniversary of the National Postal Policy Council, I realized that is just about how long I have known Mike — 15 years.

We first became acquainted in connection with a then new Postal Service product known as E-COM — short for Computer Originated Electronic Mail. Actually, it was more of a distributed printing operation. This new product came nowhere close to meeting expectations. When cumulative losses reached \$100 million — a pretty fair amount in early 1980's dollars — the Postal Service came to its senses, realized E-COM was not its future, and pulled the plug.

Perhaps there is a lesson here apropos the holiday season. Those with visions of Clement Clarke Moore's sugar plums dancing in their heads should give some consideration to Shakespeare's admonition in *The Tempest*: "The past is prologue."

### *The Postal Rate Commission*

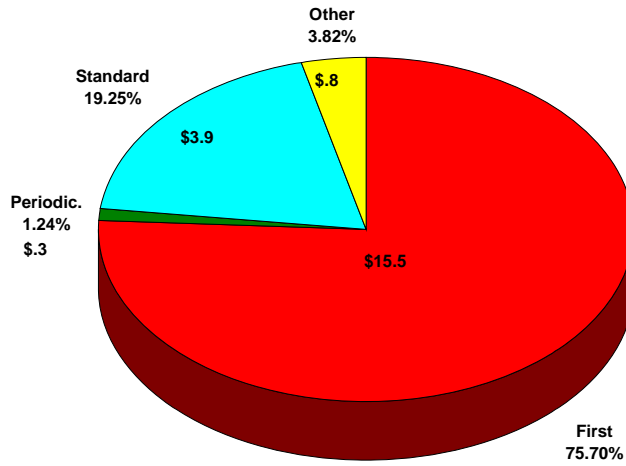
A few words about the Postal Rate Commission.

The Postal Rate Commission is, in essence, a Federal Government public utility commission, but we recommend rates for only one utility — the United States Postal Service. The law says that "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." Congress created the Commission to ensure compliance with the law and to guard against unfair exploitation of the monopoly protection it gave to the Postal Service — a protection that extends largely to First-Class Mail, the class of mail most used by the average taxpayer. One of the Congressional authors explained:

Most of the money in the postal system comes from First-Class Mail. A 100 percent increase in the rates for all second class mail would not produce as much revenue as a 5-percent increase in the First-Class rate. The temptation to resolve the financial problems of the Post Office by charging the lion's share of the operational costs to First Class is strong; that's where the money [and, for the most part, the monopoly] is. The necessity for preventing that imposition upon the only class of mail which the general public uses is one of the reasons why the Postal Rate Commission should be independent of operating management. (see Chart 1)

Chart 1  
 Contribution To Institutional Costs  
 MC95-1  
 (In Billions)

Total Contribution to Institutional Costs: \$20.5



Cost Contribution for First, Periodical and Standard Classes of Mail

	<u>% Volume</u>	<u>% Revenue</u>	<u>% of Cost Contribution</u>
First Class	53.93%	64.70%	75.70%
Periodicals	5.86%	3.82%	1.24%
Standard	39.28%	23.84%	19.25%
<b>Totals</b>	99.08%	92.35%	96.18%

In an early rate case — I believe it was 1974 — the Postal Service called as an expert witness William Vickery, a noted economist who went on to receive a Nobel Prize in economics later in his career. In that 1974 case Professor Vickery was asked “whether inverse elasticity pricing leads to a fair distribution of the revenue burden?” He replied: “Economists have no special expertise in deciding what is fair and what is not. For that you need a vicar, not a Vickery.”

Apparently Congress thought five “vicars” were necessary to ensure fair postal rates. Hence, the Postal Rate Commission. Since its creation in 1971, the Commission has handled nine omnibus postal rate cases and numerous other regulatory matters.

### *Recent Commission Experience*

I know the focus of your program today is what is in store for the future in postal affairs, and I will share some thoughts on that with you. But first I want to spend a few minutes on the recent past, since I am extremely proud of what the Commission has achieved during the last three years.

In 1994 the Commission considered the most recent omnibus rate case. It completed its consideration in record time, allowing the then financially strapped Postal Service to implement new rates one month earlier than planned, thereby improving its bottom line for fiscal year 1995 by \$500 million. In early 1996, the Commission completed the first major mail classification reform case in 25 years. Our decision was well received. The Postal Service Governors adopted it, and implementation began last July.

Earlier this year we approved, again in record time (85 days), an experimental initiative involving First Class and Priority Mail small parcels. Last May we published final rules for expedited consideration of Postal Service requests to conduct market tests, adopt provisional mail classification and rate changes, and employ multi-year test periods to determine the potential of new postal services. And, in July, we completed phase II, the non-profit aspect of classification reform. Pending before us are a Special Services rate and reclassification case and a complaint case filed by commercial mail receiving agencies.

We have modernized the Commission’s computer systems facilitating information transmission. Today, much of the “paper” filed with the Commission (motions, testimony, etc.) is received electronically saving parties time and expense. You can even follow Commission activities on our home page on the Worldwide Web ([www.prc.gov](http://www.prc.gov)).

As mailers whose postage supports the Commission, I trust you also will be pleased that we have done this with fewer staff and with no increase in our budget.

I am sure you have heard of the “Reinventing Government Initiative.” Well, I am proud to report that we have been reinventing the Postal Rate Commission.

### *The Commission’s Future*

So much for the recent past; what about the Commission’s future?

The House of Representatives Subcommittee on the Postal Service held extensive hearings during the last two years and devoted much time to postal ratemaking and the Commission. Its counterpart subcommittee in the Senate also held several hearings. Virtually no one suggested there should not be a Postal Rate Commission, other than those who advocate complete and immediate privatization of the Postal Service (and a few who still cannot accept the fact that some of the 1968 Kappel Commission recommendations were not embraced by the Congress). So, I think the Commission does have a future, although frankly I do not know if its role will change, or if it does change, what that role will be. Quite obviously the future role of the Commission depends, to a large part, on what happens with the Postal Service. That will be my focus today.

### *The Postal Service’s Future*

The Postmaster General and his top managers have offered their thoughts publicly on what the Postal Service’s future should be — a commercialized, albeit still Government-sponsored, entity — competing more aggressively in existing markets, such as express delivery (everyone has seen those Priority Mail ads), while bravely entering new markets to compete and grow. Here are just few of the potential new markets which have been noted in the trade press:

- Postal Service sponsored phone cards;
- Fastnet;
- electronic “postmarking” to time and date stamp, authenticate, and archive e-mail;
- Global ePOST — e-mail to hardcopy for next day worldwide delivery;
- NetPost;
- “Deliver America” catalog kiosks;
- WINGS — a World-wide Web Interactive Network for Government Services; and
- Pack & Send.

I understand the Postmaster General and two of his vice presidents, Alan Kane and Bob Reisner, spoke to you earlier today. I am sure they told you where today's management wants to take the Postal Service. For the last two years the Postmaster General has campaigned vigorously for legislative reform to "free" the Postal Service from regulatory constraints (i.e., the Postal Rate Commission) and give it more flexibility to deal with "people, products, and prices."

This campaign has been at least partially successful. Last summer Congressman John McHugh, who chairs the House postal subcommittee, introduced far reaching legislation which, for the most part, would deregulate the Postal Service in many competitive markets. Unfortunately, in the Postmaster General's view, the McHugh bill would also take away some monopoly power and other advantages the Postal Service presently enjoys by virtue of its Federal Government status. More on that later.

### *Should the Postal Service Expand?*

When I testified before Congressman McHugh's Subcommittee in March, 1995, I posed some questions which still are relevant today and have not been answered to my satisfaction:

. . . do we want the Postal Service to limit its focus to its historical mission — the delivery of hard-copy mail? Do we want it to become a lean, mean collection, processing, and delivery machine which probably means little growth and perhaps eventual downsizing? Or, do we want it to compete with the new technology and enter fields heretofore foreign to it? If it pursues new, competitive markets, will it be more or less likely to perform successfully? . . . Can a labor intensive organization operate in an entrepreneurial, capital intensive arena? And, since it takes \$1 billion in profit to reduce the cost of a First-Class stamp by a penny, are new ventures really worth the effort?

Is there a need for the Postal Service to compete in new markets? On paper, at least, the Postal Service appears to be doing well, both financially and operationally. It had record "profits" of \$1.8 billion in fiscal year 1995, followed by profits of about \$1.6 billion in 1996. Its press releases announce that service is also at record-high levels. Mail volume continues to grow, although a decline in the rate of increase is cause for concern, and the Postmaster General has repeatedly pointed out that the Service is losing market share in five of its six product lines.

In fairness, however, there appears to be no immediate crisis. Nevertheless, should it be looking for new markets? If the private sector is providing a product or service, should a

Government-supported entity be permitted, or even encouraged, to enter that market to grow and prosper?

Testimony given to Congressman McHugh's subcommittee last September argued forcefully that the Postal Service should mind its own business:

. . . if private companies can now do some jobs better than the Postal Service, why not let them do so without government interference? Government participation in a competitive market is always disruptive. A government "corporation" — which does not need to make a profit, does not answer to shareholders, loads its fixed costs on a legal monopoly, and cannot go out of business — behaves so differently from private competitors that it distorts the entire market. All things being equal, the only good reason for government enterprise is to provide necessary services that would otherwise be unavailable from private companies. Yet, by definition, the Postal Service will not be providing unique public services if it is participating in competitive markets.

Of course, this view comes from Frederick W. Smith, the Chairman of Federal Express Corporation — hardly a disinterested observer.

Mr. Smith and others also argue that if the Postal Service is permitted to compete, the "playing field should be level." As a Government-supported entity, the Postal Service enjoys advantages that are artificial, and unfair, in the competitive area. Its monopoly power is the most important, but others flow from its status as an entity of the United States Government.

The Postal Service has an advantage in negotiating with foreign postal administrations over matters such as customs procedures. The Federal Government is a guarantor of its debt, allowing it to borrow on terms more favorable than those available to commercial enterprises and, indeed, allowing it to borrow under circumstances in which no private sector firm could borrow. The Postal Service can exercise eminent domain in instances where it deems that advantageous to build processing, transportation, or delivery facilities. It is immune from most State and local rules. For example, it pays no parking tickets. Neither does it collect and remit sales taxes on non-postal products it sells (e.g., mugs and T-shirts), nor does it pay property tax on facilities it owns.

Mr. Smith and other competitors such as Kent C. Nelson, Chairman, United Parcel Service, have told Congress that a level playing field is an absolute prerequisite if the Postal Service is to be "commercialized," as the Postmaster General and his managers are urging. The

Postmaster General, on the other hand, has expressed concern over any “leveling” stating that Congressman McHugh’s proposal to relax (not eliminate) the postal monopoly “would put more than \$4 billion of our current business at risk.” Despite this concern, I cannot imagine that this Congress will permit the Postal Service to embark on new unrelated ventures unless the playing field is leveled. So, the question becomes, can the Postal Service compete on such a level playing field?

### *Gleiman’s Ground Rules*

In addition to a level field, there are certain ground rules which should apply if the Postal Service is going to play in the private sector.

First, any new product or service eventually must be “profitable.” By this I mean that the revenues from that product or service must be sufficient to cover costs and make a contribution to the overhead costs of the Postal Service.

Second, the “profit” from any new product or service must be significant enough to reduce the overhead cost burden now borne by the core monopoly services — First-Class Mail and Standard Class (business) addressed mail. If a new product or service turns a relatively small profit, is it really worth the effort? I suggest it is not. Consider phone cards and money orders to Mexico, two recent Postal Service initiatives. If they turn a profit of \$15 million, they would appear to be successful. But if you compare that \$15 *million* with the Postal Service’s overall overhead requirement of \$20 *billion*, you must question whether these initiatives justify the diversion of management time and attention. Psychic gratification of Postal Service managers, e.g., being on the “cutting edge” or “running with the big dogs,” does not justify forays into private sector markets. A significant benefit to the Service’s core monopoly services must be shown.

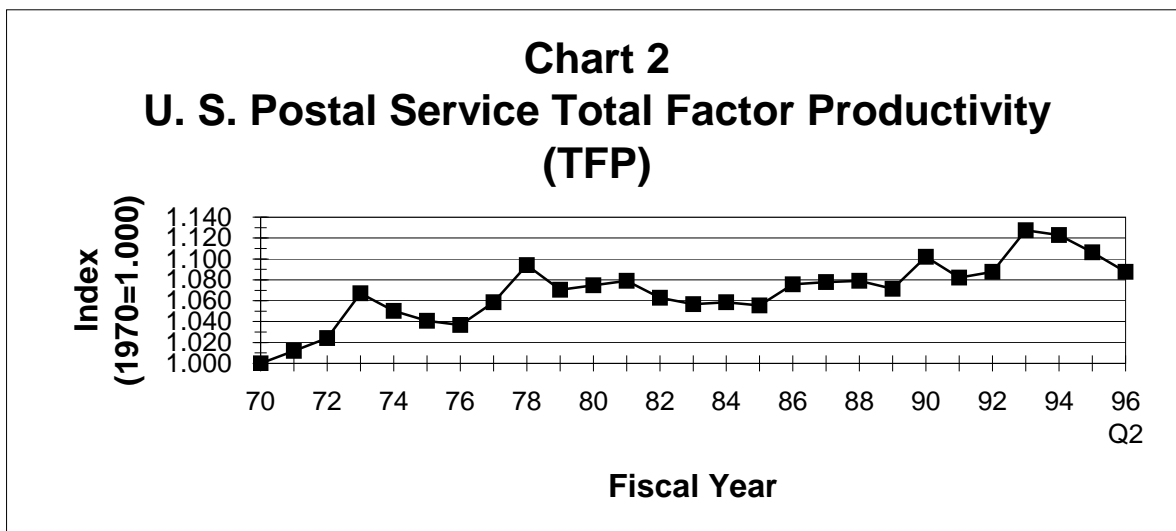
A third and final ground rule: the Postal Service should consider expanding in areas where it has a comparative advantage and where it is particularly well suited to provide the service in question. This involves several considerations. First, does the Postal Service have productive capabilities that would allow it to produce the new service particularly effectively? Second, is this a service which needs, for some reason, to be produced by a large federal entity? Third, would the new service be particularly convenient or beneficial to customers of the Postal Service?



*Could the Postal Service Compete Effectively?*

What does the record show? Is the Postal Service an efficient, “competitive,” provider of products and services? Could it compete on as level playing field? Experience is not encouraging.

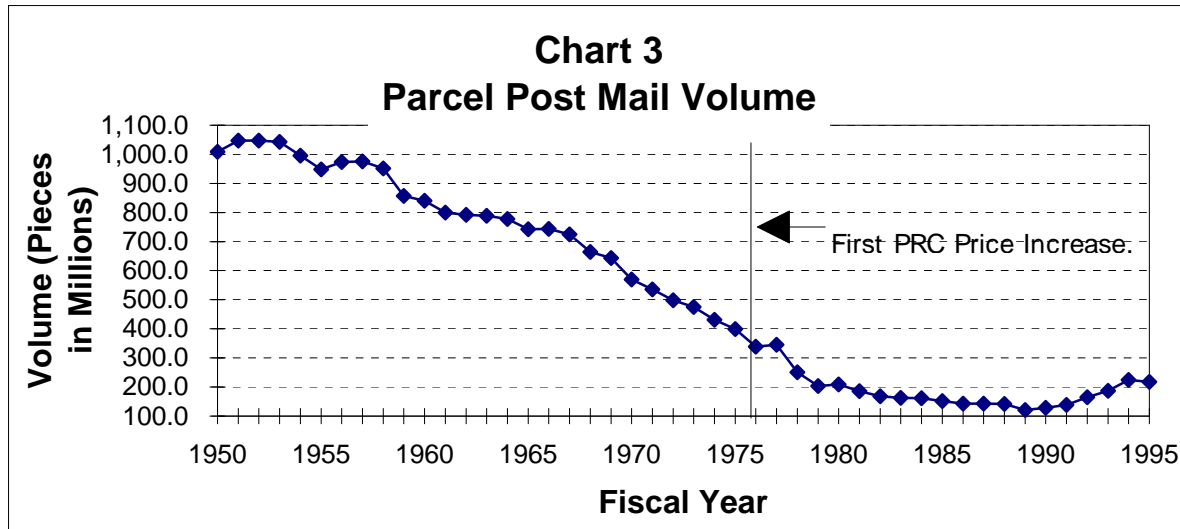
One characteristic of an efficient organization is success in holding down costs and in adopting new technologies so the company achieves productivity increases. The Postal Service uses “total factor productivity” as a measure. What’s the trend? Total factor productivity dropped 0.4 percent in 1994, 1.5 percent in 1995, and 1.7 percent through the first half of 1996. Since Postal Reorganization 25 years ago, Postal Service productivity is up an anemic total of 11 percent. (see Chart 2). This failure on the productivity front is particularly troublesome in view of the Postal Service’s investment of billions of dollars in automated equipment. In short, the postal workforce is larger today than at any point in the past, and labor costs still make up about 83 percent of total costs.



With more employees, the Postal Service should better meet its service standards that, as some will recall, were lowered just six years ago. Higher rates — such as those imposed just two years ago — when coupled with accounting changes and a bit of luck, may infuse the Postal Service with cash resulting in record surpluses. Declining productivity, however, may well bar the Postal Service from realizing its vision of the future.

How effectively has the Postal Service competed in the past? As I mentioned earlier, the Postmaster General says it is *losing* market share in five of six product lines. And we all are

familiar with the Postal Service's experience in the parcel post and expedited delivery markets.



As I said, the historical record does not suggest the Postal Service can “run well with the big dogs.”

#### *The “Bottom Line”*

So, what should be the future direction of the Postal Service? Should it strive to compete with the private sector with new products and services? Could it compete effectively on a level playing field? The record suggests it could not.

Almost three years ago, in testimony before the House Post Office and Civil Service Committee, one postal “sage” said the following:

In the end, the Postal Service is faced with a fundamental question. Will it, as a \$50 billion [now \$60 billion] entity, be able to innovate to the degree that it creates dozens upon dozens of highly profitable multi-hundred million dollar new businesses? I think that is unlikely. . .

Instead, that observer suggested “we need to make a rough approximation of what a ‘leaner and meaner’ Postal Service will look like. . . and then begin moving toward that goal.”

Those were the words of your Executive Director, Mike Cavanagh. That was good advice then. It is good advice now. Those charged with plotting the future direction of the Postal Service should take heed.