

**TESTIMONY OF GEORGE A. OMAS
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BEFORE THE SPECIAL PANEL ON POSTAL REFORM
OF THE COMMITTEE ON GOVERNMENT REFORM**

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

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

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

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

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

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

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

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

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

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

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

Id. at vii.

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

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

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

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

The President’s Commission unequivocally recommends the latter course. In addition to adopting corporate “best practices,” the Commission recommends

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

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

ENHANCED POSTAL SERVICE FLEXIBILITY AND ITS RESPONSIBLE EXERCISE

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

recommendations are contingent on a strong, independent Regulatory Board with a clear mandate to protect the public interest.

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

The President's Commission contemplates that, following a PRC proceeding to establish "baseline" rates, the Postal Service would be afforded pricing freedom within broad constraints. Rates for non-competitive (monopoly and market-dominant) products could be set at whatever level management chooses so long as they meet two tests: rates for each product must cover its costs, and rates for a product may not increase faster than an inflation-related metric established by the regulator. Rates for competitive services would be required to recover all their allocable costs to assure that cross-subsidies from non-competitive products do not occur.

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

MECHANISMS OF ACCOUNTABILITY AND PUBLIC RESPONSIVENESS

The President's Commission's report concludes that: "The Postal Service's need for oversight today is as broad as the PRC's authority is narrow." (Report at 55.) On the basis of this assessment, the Commission recommends

that a Postal Regulatory Board be vested with substantially expanded regulatory authority. The Regulatory Board's authority would encompass not only ratemaking matters such as appropriate cost allocations, the prevention of cross-subsidies, and extraordinary (above inflation) rate increases for non-competitive products and services, but also oversight of the appropriate scope of the postal monopoly, proposed changes to service standards, and the scope of the universal service obligation. The PRB would also be tasked with ensuring the Postal Service's financial transparency, the comparability of its employee compensation to private sector benchmarks, and the consistency of its level of accumulated retained earnings with the public interest. (Report at 56, Exhibit 4-1.)

The PRC fully agrees with the President's Commission's premise in this area: that the enhanced level of autonomy it recommends for the Postal Service in its future operations should be matched by a correspondingly rigorous degree of public policy oversight. Particularly in light of the Postal Service's retention of the letter and mailbox monopolies, strong regulatory oversight is a crucial element of comprehensive postal reform. Further, the successful operation of the recommended system of regulatory oversight will depend on vesting the regulator with sufficient discretion to achieve a balance between potentially competing interests and potentially competing objectives.

A. New System of Rate Regulation

The President's Commission recommends that the Regulatory Board, among other functions, exercise broad public policy oversight to ensure that revenues from non-competitive products are not used to subsidize the provision of competitive services. This recommended duty appropriately recognizes the importance of preventing such cross-subsidies to both users of monopoly services such as First-Class Mail, and to private sector firms that should be protected from unfair competition from their government.

The Regulatory Board would also oversee Postal Service cost recovery, ensuring that its costs are appropriately distributed across its competitive and

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

The President's Commission contemplates that the rates for non-competitive (monopoly and market-dominant) products also could be set at whatever level management chooses so long as they meet two tests: rates for each product must cover its costs, and rates for a product may not increase faster than an inflation-related metric established by the regulator. The first test exists today, and is well understood. The second test is new, and the President's Commission views it as an important incentive to make the Postal Service manage itself more efficiently.

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

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

B. Postal Monopoly and Universal Service

Another essential responsibility of the Regulatory Board involves the recommended oversight of both the scope of the Postal Service's monopoly and that of its universal service obligation. The President's Commission report recommends that the PRB's roles include "defining the scope of the postal monopoly, refining the appropriate components of the universal service obligation,

and establishing the bright-line boundaries between the postal monopoly and competitive markets.” (Report at 62.) The Commission provides sound public policy rationales for assigning these functions. (Report at 65.) However, the general criteria for defining the appropriate scope of Postal Service operations may merit further clarification before legislation is enacted.

Historically, a premise of postal policy has been that the purpose of the monopoly is to assure the preservation of a satisfactory level of universal service. The PRC suggests that any legislation implementing postal reform should explicitly direct the regulatory body to consider preservation of an adequate level of universal service as the principal criterion when reviewing the scope of the postal monopoly.

Under the President’s Commission’s recommendations, the Regulatory Board would also exercise two new forms of oversight regarding services the Postal Service provides. First, the PRB would monitor the types of products and services offered by the Service to ensure it does not exceed its core mission. Second, the Regulatory Board would review changes in service standards proposed by the Postal Service that might have a substantial negative national impact.

The first function presumes that new legislation will clarify national policy on the appropriate areas of Postal Service business. The Postal Service’s provision of “non-postal” services, and their relation to the Service’s core postal functions, have given rise to vexing policy questions — and several contentious PRC proceedings — in recent years. The second function would expand a jurisdictional duty currently performed by the PRC, and would affirmatively contribute to safeguarding the public interest in preservation of the quality of services provided by the Postal Service.

The President’s Commission further recommends that the Regulatory Board exercise public policy oversight over two fundamental features of the nation’s postal system: the appropriate scope of the Postal Service’s monopoly,

and that of the universal service obligation. Currently, the Postal Service exercises broad responsibility for defining the nature of universal service and the scope of its monopoly. This recommendation of the President's Commission would transfer this governmental responsibility from the operator of the postal system to the regulatory agency that would oversee the operator. Transferring these functions as recommended by the Commission involves issues of national postal policy worthy of congressional consideration.

C. Expanded Authority to Hear Complaints

The President's Commission recommends that the Postal Regulatory Board hear and resolve a variety of complaints from the public. The PRB would consider complaints that rates are unlawful either because of alleged cross-subsidy, or because rates are inconsistent with applicable ceilings. Additionally, the Commission contemplates the Regulatory Board hearing complaints that the Postal Service is acting unlawfully, for example by entering a market outside the scope of its mission. (Report at 65, 68.)

The Complaint process envisioned by the President's Commission supplies a substantial amount of public protection not present in the current law. The Postal Regulatory Board would be expected to promptly hear, and resolve, complaints that the Postal Service was acting contrary to public policy. Providing the PRB with authority to order appropriate remedial action when a complaint is found justified (Recommendation C-4) should substantially eliminate current concerns that the Postal Service is not held accountable for its acts.

Public protection would be strengthened even more if the complaint process suggested in the President's Commission report were augmented by authorizing the Postal Regulatory Board to initiate proceedings whenever it has good cause to believe that existing rates are contrary to law. This might occur if rates for a product have fallen below properly allocated costs, or if Postal Service retained earnings grow to exceed applicable limits. Even with the expedited procedures recommended by the President's Commission, many small and

medium sized mailers might not wish to commit resources to pursuing an administrative complaint. Mailers' confidence in the fairness of the system will be enhanced by the knowledge that an independent agency is authorized to initiate proceedings to assure that rates conform to statutory standards.

The PRC suggests that it would be consistent with the goals of accountability and public policy oversight to allow the Regulatory Board to hear not only complaints concerning new discounts, but also complaints alleging that changes in processing procedures, or other events, have caused existing discounts to exceed savings to the Postal Service. Additionally, public confidence that rate discounts are fair would be enhanced by making the independent regulator, as well as the Postal Service, responsible for ensuring that worksharing discounts do not exceed actual savings. This responsibility could be exercised by initiating a complaint proceeding to evaluate questionable existing discounts.

The same considerations are applicable in the area of negotiated service agreements (Recommendation P-5). The President's Commission suggests that the Postal Regulatory Board should develop general criteria for such agreements and conduct after-the-fact reviews if a written complaint is filed. However, public confidence in the integrity of the system would be enhanced if the independent regulator was responsible for assuring that every negotiated service agreement between mailers and the Postal Service is consistent with applicable policies, whether or not a private party files a complaint.

FINANCIAL SELF-SUFFICIENCY AND FAIRNESS TO STAKEHOLDERS

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

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

Obviously, Congress must carefully consider and weigh all of these recommendations in developing postal reform legislation. In doing so, care should be taken to assure the preservation of the Postal Service's honored tradition of binding the nation together by making affordable service readily available to all. Americans trust their Postal Service to meet their needs, regardless of geographic location or economic circumstances. This trust has been earned through decades of dedicated service, and it must not be squandered.

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

The system of rate regulation recommended by the President's Commission would appear to raise several such concerns. First, because the strongest form of rate regulation would apply to non-competitive services (including First-Class Mail), there would be a natural incentive to control costs by all means available — including measures that might compromise the level of

service provided to users. While the President's Commission recommends that the Postal Regulatory Board be assigned jurisdiction over *proposed changes* in service standards that may have a substantial negative national impact, it does not explicitly address potential erosion in service levels that might result from cost-cutting programs. For this reason, in the PRC's view, the regulator should also have authority to ensure that appropriate levels of service are maintained.

Furthermore, should the Postal Service seek to raise rates for non-competitive mail above the applicable inflation-based cap, there may be sound policy reasons for allowing captive customers to do more than just submit written protests, as proposed. The President's Commission evidently believes that there are so many cost cutting opportunities available to the Postal Service that years should pass before rates might have to increase above the rate of inflation. However, if this view turns out to be overly optimistic, captive mailers could be subject to repeated increases in excess of inflation with no opportunity to explore the causes of those increases.

The President's Commission seems to believe that as long as rate increases are moderate, even captive monopoly mailers have no grounds for complaint. When increases exceed the rate of inflation, however, the justification for allowing postal management to impose ever-increasing burdens with only minimal user participation largely disappears.

This is not a purely theoretical problem. In a past general rate case (PRC Docket No. R94-1) the Postal Service proposed a rate increase of 34% for In-County publications. These mailers had been in discussions with the Service about data discrepancies before that case was filed, but without satisfactory resolution. After the Postal Service filed its request, affected mailers intervened and directed discovery to the Postal Service that forced it to acknowledge data collection errors. The Postal Service eventually altered its proposal and requested a rate reduction for this mail — but this change took place more than 60 days after the initial request was submitted. Thus, mailers may wish to

comment on: (1) how much public participation should be permissible when large rate increases are involved; and (2) whether a 60-day written-submissions-only case will provide meaningful participation.

GUARANTEEING POSTAL SERVICE TRANSPARENCY

Lastly, I cannot overemphasize the importance of ensuring that a reformed Postal Service become financially transparent, as the President's Commission recommends. In the PRC's view, establishing a financially transparent Postal Service is essential to assuring that it will function as a successful, performance-driven public service in the future.

The President's Commission report envisions "a healthy and efficient Postal Service that consistently operates at a high standard of excellence and delivers service quality, productivity and performance on a par with the nation's leading corporations." (Report at 36.) As the Commission also recognizes, assurance of financial transparency provides the essential framework for public confidence in the empowered managers and strong Board of Directors charged with achieving this vision. This is because timely, detailed and verifiable financial data will serve as a principal resource for documenting the Postal Service's business performance.

Furthermore, financial transparency — in the form of immediately accessible basic data about Postal Service finances and operations — will be an indispensable tool for implementing effective oversight of a transformed Postal Service.

The President's Commission recommends strong regulatory oversight performed with extreme expedition; in the case of ratemaking for non-competitive postal products, it recommends that all final determinations be rendered within 60 days. The availability of highly detailed, frequently-updated cost and other financial data are a practical imperative for conducting meaningful regulatory

review of both proposed rate changes and complaints within the recommended timeframe.

The regulator's ability to perform the functions envisioned by the President's Commission will depend critically on the availability of adequately detailed data to enable informed expeditious review. This could encompass both information the Postal Service has on hand for its own operational purposes and other specialized data necessary for regulatory review. For this reason, it is the PRC's view that the regulator should be vested with authority not only to compel the production of information already prepared by the Postal Service (*i.e.*, subpoena power), but also to compel the collection and reporting of additional data reasonably required to perform its regulatory functions.

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

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