UNITED STATES POSTAL SERVICE

**STATEMENT OF
JOHN E. POTTER
POSTMASTER GENERAL/CEO
BEFORE THE
SUBCOMMITTEE ON FEDERAL WORKFORCE, POSTAL SERVICE
AND THE DISTRICT OF COLUMBIA
OF THE
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM
UNITED STATES HOUSE OF REPRESENTATIVES
WASHINGTON, DC**

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Good morning, Mr. Chairman and members of the Subcommittee. I appreciate the opportunity to meet with you today to discuss the Postal Service's approach to setting prices – both from the perspective of the requirements of the Postal Reorganization Act of 1970 and the vastly changed pricing structure established by the more recent Postal Act of 2006.

Over the last decade, the Postal Service, virtually all elements of the mailing community, Congress – including members of this Subcommittee – and the Administration, have recognized the compelling need to modernize an outdated postal pricing regulatory model. It was a model created for another time, a simpler time, a time when the postal monopoly had not become virtually irrelevant through the explosion in electronic communications and the development of an intensely competitive package and document delivery market, one that includes domestic as well as international competitors.

That model was marked by a cost-of-service pricing regime, with each subclass of mail required to cover its full attributable costs and make a contribution to overall system overhead costs. It was a contentious model, with each omnibus rate adjustment marked by up to ten months of litigation before the former Postal Rate Commission, during which a wide range of intervenors would be heard, each offering data, testimony, and other information in support of their positions regarding the Postal Services' pricing proposal.

Because that pricing model was, essentially, a zero-sum game, if an intervenor was successful in influencing the Commission to recommend that its prices be less than those proposed, the difference had to be made up by obtaining those revenues from other classes or subclasses of mail. The Commission's role was to produce a recommended decision that met the Postal Service's specific, stated revenue requirement, but, significantly, the Commission was not required to adhere to the Postal Service's allocation of that requirement among the various categories of mail through its proposed prices.

There may be no better example than the most recent rate case, of the drivers that ultimately made it abundantly clear that a simplified, modern, and far more accountable pricing system was needed. This was the system established by the Postal Act of 2006.

As I mentioned, the Postal Reorganization Act required that the prices we charge for our products and services match the overall direct and overhead costs of providing those services. Over time, and for a number of reasons, we had seen some deterioration in the cost coverage of some products – most notably Periodicals, which includes newspapers and magazines. Prior to our rate filing of 2006, which led to our current price structure, we did not have a traditional rate case since 2000.

In 2001, the nation experienced a swift economic downturn following the terrorist attacks of 9/11. This affected mailing patterns and mail volume, resulting in a significant and almost immediate downturn in revenue. Only weeks later, this was exacerbated by extraordinary and pressing revenue needs for the decontamination of a number of our facilities and the protection of our network following its breach by the deadly anthrax mailings. We were fortunate that Postal Rate Commission Chairman George Omas was sensitive to our needs. Through his leadership, he influenced the greater part of the mailing community to agree to a settlement, eliminating months from the hearing process, allowing us to implement new rates quickly.

As some members of this Subcommittee may recall, the enactment of a 2003 law changed the Postal Service’s funding obligations to the Civil Service Retirement System, to avoid a considerable, long-term overpayment. While this was a welcome event, it did require that, beginning in 2006, the “savings,” the difference between the old payment schedule and the new, be placed in an escrow account, pending Congress’ direction on how those funds would be used. To fund the escrow account – which came to $3 billion in 2006 – we filed for an across-the-board rate increase of 5.4 percent, an amount sufficient to satisfy the escrow requirement. Absent the requirement to make a cash payment into the escrow account by a date certain, we had not intended to file a regular omnibus rate case before 2006.

Because the method of disposition of both of these rate cases – each based on unique and compelling circumstances – there was not an opportunity for a full examination by the mailing community of the relationships between the rates charged for our various products and services, and our costs of providing them. During that period from 2000 to 2006, our costs continued to rise, as they did for all businesses.

At the same time, we continued to improve network efficiencies and implement more productive technologies that helped to limit cost growth for some of our higher volume products. While, in many cases, these efficiencies – including more efficient preparation by some mailers – helped to avoid large variances in cost coverage, for some categories, this was not the case.

By the time we filed our 2006 omnibus rate case, relative cost coverages had become markedly skewed, with some revenues actually below our costs – which meant we lost money on every piece handled – a situation at variance with the requirements of the law. Even for those Periodicals that were covering their costs, their institutional contribution remained significantly below that of other classes. This was consistent with the long-term actualities of Periodicals pricing strategies, which, recognizing the important role played by these publications in the intellectual, social, and political life of our nation, generally resulted in lower overhead contributions. This also reflected the Postal Reorganization Act’s requirement that such factors be considered in establishing rates.

On average, the Postal Service experienced relatively steady mail volume growth from 2000 to 2006. With some year-to-year variations, total volume of 208 billion pieces in 2000 grew to a record 213 billion pieces six years later. However, a deeper examination of volume trends over that period showed that Periodicals mail declined by some 13 percent, an average of two- to three-percent a year, as publishers faced the ongoing and disruptive innovations of the internet and the increasing ubiquity of alternate sources of information and advertising.

This situation is not unique to publications whose primary distribution channel is the mail. It is also affecting some of America’s largest and best known newspapers, which utilize alternate means of home and office delivery, as well as the not inconsiderable newsstand component of magazine and newspaper distribution. And print publications – both large and small – have been taking advantage of the internet by posting on-line editions of their publications, with some or all of their content available without cost.

While some larger publishers, because of the mail volumes they enter, even though tempered by some circulation declines, have been able to better manage their postal costs through more efficient mail preparation and presentation, this is not the case for all mailers. The publishers of many smaller circulation Periodicals, which do not individually have sufficient circulation density in many postal delivery areas to prepare their mail with similar levels of efficiency, have not had the same success in cost management.

As an example, many smaller publications are presented to the Postal Service in sacks containing only a small number of pieces. Because of the high degree of manual handling required to process sacked mail when compared to other, more efficient containers such as pallets, which contain far greater pieces and are less prone to bundle breakage, our labor costs for handling sacked mail are much higher. We must account for these costs in our rates.

Over the years, we have worked closely with Periodicals mailers to work toward more efficient preparation and presentation, with the intention of reducing the costs associated with handling this product, which would be reflected in the prices paid by these mailers. Significantly, in 2003, we began a co-palletization experiment – supported by a rate structure that reduced per-piece prices by less than one cent – to encourage the mixing of multiple publications from multiple publishers on pallets. This very small price incentive contributed to a 50 percent increase in the use of pallets for Periodicals by 2005.

As we prepared our 2006 rate filing, one important goal was to continue to try to correct the imbalances in cost coverage that had developed over the years. Through our day-to-day contacts and communications with publishers, particularly those with smaller circulations, they were clear in explaining their understandable sensitivity to larger rate increases. As we developed our pricing proposal for filing with the former Postal Rate Commission, we were able to accommodate both of these needs. Cost coverage would have been revised to more appropriate levels and price increases – not only for small publishers, but for medium and large ones as well – would have been limited to a relatively narrow variance around the mean.

Another goal was to provide mailers with incentives to move to more efficient mail preparation and presentation. To accomplish this goal, we proposed a container rate of $0.85 for Periodicals. In practice, this would mean that the container rate for a sack would be the same as the container rate for a pallet – which holds about 40 times more mail than a sack. Mailers could save by moving to fewer and larger containers.

However, as I noted earlier, the rate-setting process established by the 1970 law is complex, with any gain for one mailer involving a loss for another. By the time the Postal Rate Commission issued its recommended decision, the process had expanded the rate bands of our original Periodicals pricing proposal considerably, with the greatest variances for smaller publications. Our proposal of a price adjustment of about 12 percent was accepted. However, some smaller publications saw prices increase by as much as 25 to 30 percent, with prices lowered for other publishers.

Following the long months of hearings, our proposal for a simple container charge of $0.85 was expanded to 55 different rates for different types of containers and different levels of preparation, which led to the wide variation in price increases experienced by different publishers.

During the course of the rate case, we communicated frequently with the mailing community about the Postal Service's rate proposal to assist in their understanding of what they might expect so they had sufficient time to begin preparing for the changes. We also provided an unprecedented number of opportunities to comment on the proposed mail preparation requirements that would be necessary to support the Postal Service's proposed new rate structure. While it would be unrealistic to expect any customer to be pleased with a price increase – for mail or any other product or service – it was our intention to provide as much information as possible to ease the transition to the new rates and preparation requirements when the process was complete and rates were ultimately adjusted.

In this instance, however, I believe it is fair to say that the outcome was unexpected. It was historically unusual for the Commission's price recommendations, produced through ten long months of the litigious 1970 rates process, to differ so markedly from our original proposals. Because of the extraordinary complexities of the recommended Periodicals pricing decision, the Board of Governors voted to defer implementation for four months – granting Periodicals mailers twice the amount of preparation time provided to other mailers. We did not believe it would be possible for either mailers or the Postal Service to complete rates software and supporting mailing standard changes more quickly than that.

Another contentious element of the outcome of the 2006 rate case involved Standard Mail flats – primarily catalogs. As our processing and transportation networks continue to evolve and become more sensitive to the shape of an item rather than its weight, we crafted our pricing proposal to encourage mailers to align their mail with the changed capabilities of today's processing system.

Over the past two decades, we have made a tremendous investment in letter mail automation, including sorting mail into the delivery sequence on each carrier route, unlike Periodicals, which are entirely flats. Because letter mail volume (156 billion pieces in 2006) and its attendant revenue is significantly higher than that of flats mail (54 billion pieces) or packages (3 billion pieces), our technological advances in mail processing have focused primarily on development in this area, as it has offered the greatest return on investment.

Our pricing proposals reflected this fact, with rates more closely aligned with the actual costs of processing mail of various shapes, with the lowest costs for letters, even those of the same weight as differently shaped pieces. In some cases, such as heavier letters, our proposal actually called for lower prices. From the time we first announced our rate proposal, through the review and hearing process, and well into implementation, we have been advising mailers to shift to more advantageous shapes – when appropriate, based on their business needs – to benefit from this new approach to pricing.

We were optimistic that the merits of this technique would gain the acceptance of the Postal Rate Commission, which turned out to be the case. However, neither we nor the larger mailing community anticipated that the recommended decision would take to this approach far more aggressively than we had proposed. As a result, rates for Standard Mail flats far exceeded those we had proposed. It was our intention that this process of promoting a shift to more efficient shapes be more gradual.

Like the catalog mailers, the Governors of the Postal Service felt the more moderate pace represented by our proposal was preferable, addressing the needs of the Postal Service and better representing the needs and abilities of mailers, and avoiding the disruptive effects of rate shock. And, because catalogs generate a great deal of additional mail through orders, payments, and order fulfillment, we did not want to place catalog volume at risk. That would have been damaging to our business, to the catalog business, and to the suppliers and partners of the catalog companies. As a result, the Governors requested that the Commission reconsider its decision, suggesting a reduction in flat rates and a slight increase for letters.

The Commission's response recommended a limited rate reduction that would last for an eight week period. Rates would then have reverted to the higher levels previously recommended.

Unfortunately, this would have cost the Postal Service some $100 million in revenue and many mailers would have been unable to make necessary system and software adjustments in time to take full advantage of the reduction. The Governors reluctantly voted to proceed with the Commission's original recommendation. In addition, despite the Periodicals and Standard Mail recommendations, the Commission met the Postal Service's revenue requirement – although assigning revenue burdens differently than our proposal – which was within its authority, limiting the basis of any objections on our part.

Looking ahead, we will continue our work with the industry to help find ways to manage our costs and those of the mailing community. The development and implementation of the Intelligent Mail Bar Code is one tool we have been using. Used by an increasing number of mailers each day, this code will contribute to better address practices, improving address accuracy, and reducing undeliverable pieces. There are billions of dollars in potential savings in this area.

As we focus on shape-based processing, we are making better use of our equipment by commingling Periodicals Mail and Standard Mail. While this does not affect the delivery standards or delivery performance for either class of mail, it does reduce our processing costs by increasing the throughput and efficiency of our automated sorting equipment. Mailers of both classes will benefit.

By the end of the year, we will be deploying the first production model of our state-of-the-art automated Flats Sequencing System. This will sort larger envelopes, Periodicals, and catalogs into the actual sequence mail is delivered on each carrier route, greatly enhancing sorting and delivery efficiency. This operation is currently performed by costly manual sortation. As we work toward full deployment of this equipment, its efficiency gains should improve the outlook for flats prices.

The ultimate success of all of these initiatives will depend on strong participation by the mailing industry. This transformation will take time to complete, but the Postal Service believes these steps will result in a more efficient, responsive, and business-like organization, as foreseen by the Postal Act of 2006.

But beyond the changes we are making to our own operations to offset costs, mailers will also benefit by the new rates process established by the new postal law. We welcome these changes.

We also believe that there are actions that can be taken by Periodicals mailers to lower their mailing costs. Eliminating sacks and shifting mail to pallets is one example. By doing this, mailers would see an immediate reduction in their total container charges and could qualify for deeper drop-shipping discounts. In the longer term, because palletized mail can be handled more efficiently than sacked mail, savings to the Postal Service would be reflected in future price changes. Where palletization may present challenges to publishers with smaller circulations, we encourage co-palletization, which would bring the cost benefits of palletization to each participating mailer. And co-mailing with other mailers can increase opportunities for workshare discounts.

Overall, the new rate regime offers a degree of predictability and simplicity that will be advantageous to mailers. We also believe it can avoid the contentious situations we experienced this year.

Pricing postal services will no longer be an adversarial process. Granting the Postal Service the ability to transform from a break-even financial model to one that encourages retained earnings for reinvestment means that the rates process will no longer be a zero-sum exercise.

Price changes for our market dominant products – primarily First-Class Mail, Standard Mail, and Periodicals – will now be capped by the rise in the Consumer Price Index on an annual basis, eliminating the irregular and sharp increases under the old system.

The role of the new Postal Regulatory Commission before the implementation of new prices will be to review them to be sure that they have not exceeded the cap. The Commission will also have the authority to accept and adjudicate issues raised by customers after new rates have been implemented, and direct the Postal Service in their resolution.

And without an inordinately lengthy review and hearing process, the Postal Service will have the needed flexibility to adjust prices and product offerings quickly in response to dynamic market conditions and customer needs.

In closing, I would like to thank the Subcommittee for the opportunity to discuss these issues with you today. The Postal Service would also like to acknowledge the untiring efforts of the Postal Regulatory Commission in helping to implement the provisions of the new law, and we look forward to implementing a new pricing structure as envisioned by Congress.

I would be pleased to answer any questions the Subcommittee might have.

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