

**Remarks of
Edward J. Gleiman, Chairman
Postal Rate Commission
Before the
Midwest Direct Marketing Association
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I want to thank Jim Anderson for arranging to have me visit with you today and for the kind words of introduction.

I'm still having difficulty with the title—Chairman. Every time I hear it, I look over my left shoulder to see whether my former boss, who was chairman of a Senate committee is standing there. I mentioned this to a coworker who suggested I might be more comfortable with plain old "mister." Unfortunately, every time someone calls me Mr. Gleiman I look over my right shoulder to see if my Dad is standing there. When I mentioned this problem, the colleague suggested that I have people call me "Mr. Ed"—and, he added, "hopefully, at the end of your tenure, they'll think of you as the front end!

[Now, so that you won't be too disappointed with my speech, let me lower your expectations a bit. You need to know that my public speaking experience is somewhat limited. You see, prior to coming to the PRC about fifteen months ago, I spent the better part of my adult life as a "whisperer." What, you might ask, is a "whisperer"? Well, as my Dad explained to a friend of his who wanted to know what his son, the congressional staffer, really did, (and I quote) "haven't you ever seen one of those congressional hearings on C-span—my son is one of those guys who is always whispering in the Senator's ear—he's a whisperer!" So, please keep in mind that speaking out loud, in complete sentences and paragraphs, is a relatively new experience for me.]

As you may know, MC95-1, the major reclassification case filed by the Postal Service on March 24 is before the Commission. Since it is pending business, the confines of something called the Administrative Procedure Act preclude me from discussing the substance of that case. Nevertheless, if time permits and you have questions about reclassification, ask them. I will try to answer them—to the extent I can without getting into trouble.

The preliminaries having been dispensed with, I would like to address four areas today. First, I want to tell you about the Postal Rate Commission—who we are and what we do. Then, I would like to explore with you the stakes in postal ratemaking—how the \$54 billion postal pie is sliced. Third, I want to share some concerns with you. Finally, I want to look to the future. What does the future hold for the Postal Service? And, what is the Commission doing to help it prepare for the future?

The Postal Rate Commission—who are we and what do we do?

The Postal Rate Commission is an independent Government establishment consisting of five Commissioners and 48 employees. We are separate and apart from the Postal Service, which employs more than 800,000.

While we are small, we play a very important role in postal affairs. In 1970, Congress had tired of managing a Post Office Department that required larger and larger taxpayer subsidies to stay afloat. It also had grown weary of the political brawls involved in setting postal rates. It created the Commission and gave it the statutory responsibility to ensure that postal rates and fees are reasonable and equitable, and sufficient to enable the Postal Service to maintain and continue to provide postal services.

The Commission was also charged to prevent the unfair exploitation of the monopoly afforded the Postal Service under the Private Express Statutes; a monopoly that applies to more than 80 percent of domestic mail volume and generates in excess of \$42 billion of the Postal Service's annual revenues of about \$54 billion. The Commission is the only check on the Postal Service in this regard.

We are similar to a public utility commission, but we recommend rates for only one body, the Postal Service. We also house the Office of the Consumer Advocate (OCA) which the law requires "to represent the interests of the general public" in rate and classification cases. The OCA helps the Commission develop a complete and accurate record, and it argues for equity on behalf of the general public—principally, those segments not otherwise represented in rate or classification proceedings.

Our primary responsibility, is recommending postal rates. Since its creation the Commission has issued recommended decisions in nine omnibus rate cases, or cases that affect all classes of mail. By law, a rate case should be decided in 10 months. A typical case will involve 75 to 100 parties, 100 to 150 witnesses, tens of thousands of pages of testimony, many, many days of public hearings, and decisions which are based on a public evidentiary record.

I am proud to report that the Commission issued its Recommended Decision in the last case—my first—five weeks ahead of the 10-month statutory deadline, enabling a financially-strapped Postal Service to implement new rates that much earlier and realize an additional \$500 million in much-needed revenue.

You may have heard reports recently about how well the Postal Service is now doing financially—currently running in the black to the tune of a billion plus dollars. Postal officials can not seem to find enough adjectives to praise themselves for this fantastic turn-around. Well, I think I should pause for a moment right now so that you can all pat yourselves on the back and I'll do the same. While we, the Commission, enabled the Postal Service to increase rates sooner, you folks are paying those higher rates—and keeping volume up. Without all of you and us, at the PRC, there might not be quite the "financial management miracle" at postal headquarters!

Turning to our other responsibilities. We hear mail classification proceedings; and as I mentioned, we are now engaged in the most complicated and potentially far-reaching reclassification case ever. These are proceedings that determine the mail groupings, or classes and subclasses, for assigning rates. Since postal reorganization there have been 43 separate mail classification proceedings.

The Act gives us some guidance on how to proceed in these cases. There are five specified factors we must consider, and a catchall. [The five are:

- the establishment and maintenance of a fair and equitable classification system for all mail;
- the relative value to THE PEOPLE of the kinds of mail matter entered into the postal system and the desirability and justification for special classifications and services of mail;
- the importance of providing classifications WITH extremely high degrees of reliability and speed of delivery;
- the importance of providing classifications that DO NOT require an extremely high degree of reliability; and
- the desirability of special classifications from the point of view of BOTH the user and of the Postal Service.

The "catchall" factor is "such other factors as the [Postal Rate] Commission may deem appropriate."]

Separate and apart from our rates and classification duties, persons who believe that postal rates or services provided do not meet the requirements of the Postal Reorganization Act may file complaints with the Commission. Complaints concern a wide range of topics. For example, the Commission has heard assertions that the rates for third-class carrier route catalogs are too high, as well as objections to a change of less than two hours in the delivery time of mail to the Farmers State Bank of Huntley, Minnesota. Some of you may recall our effort in 1992, at the behest of major mailers (2nd and third class), to investigate why about one quarter of mail processing costs were characterized by the Postal Service as "non-productive time." The Service chose to ignore the concerns of many of its largest customers and refused to cooperate. In the absence of authority to subpoena the Postal Service, there was little the Commission could do on behalf of mailers.

Similarly, the Postal Reorganization Act gives the Commission an advisory responsibility with respect to proposed nationwide or substantially nationwide changes in postal service. If the Postal Service proposes to make such a change it must submit the proposal to the Commission which then must hold public hearings on the proposal. The most recent advisory effort took place in 1989, and involved the lowering of delivery service standards—a proposal Senator David Pryor, then chair of the Senate postal subcommittee, characterized as cutting off the top of the flagpole to make it look like a stuck flag was really flying from the top.

Another of our responsibilities involves the review of post office closings when we are petitioned to do so by affected towns-people. The Postal Service does NOT have to get our approval to close a facility and we get involved only when a Postal Service decision is appealed. About ten percent of closings—some 250—have been appealed over the past twenty years and a large majority of those cases have been affirmed.

Finally, from time-to-time the Congress asks the Commission to conduct studies of particular subjects. The most recent request resulted in a report on incentives for mailers to use recycled materials.

The Stakes—How the Postal Pie is Sliced?

The Postal Service should be self-sufficient and the Postal Reorganization Act directs that rates allow it to operate at "break even." Since Postal Service revenues from all sources should equal expenses, rates must be established to achieve this equilibrium.

The Commission must recommend rates that provide sufficient revenues to equal total estimated costs for the Service, including operating expenses, depreciation, and debt service.

The stakes in an omnibus rate case are enormous. And, once the overall revenue requirement is established, a rate case is a zero sum game—each subclass must provide enough revenue to cover its attributable costs and make a reasonable contribution to overhead. Today, there are 17 subclasses of mail, which means the postal pie is divided into 17 pieces. In addition, there are more than 100 worksharing discounts, which affect the postage paid by different mailers.

You should have a hand out which shows how the postal pie is sliced in several respects.

Figure 1 shows how total postal revenues are divided to cover attributable (generally, volume variable) costs and institutional (generally, overhead) costs. Under the law, rates are supposed to be cost-based, that is, each class of mail is supposed to cover its attributable costs. Those costs that cannot be attributed, the institutional (or overhead) costs, are then divided among the various classes and subclasses based on policies prescribed in the law. Figure 1 shows that roughly two-thirds of the revenues are devoted to attributable costs with the remaining one-third covering overhead.

Figure 2 shows the revenue each class provides. First-Class Mail provides about two-thirds of all revenues; third-class about one fifth; with 2nd-class, 4th-class, and other mail providing the remaining 14 percent of revenues.

Figure 3 shows how the almost \$20 billion in institutional costs are spread among the classes—First Class pays 76 percent; third-class 18 percent; and the rest relatively small percentage portions.

Clearly, and I am sure this is no surprise to this audience, First-Class and third-class mail are the financial backbone of the Postal Service both in terms of revenues and contributions to overhead.

Figure 4 shows the volumes, revenues, and contributions to institutional costs of First- and third-class mail. Overall, First-Class Mail comprised about 54 percent of volume, produced about 65 percent of revenues, and paid nearly 77 percent of the overhead of the Postal Service. Third-class mail, on the other hand, comprised about 39 percent of volume, produced about 21 percent of revenues, and paid 18 percent of the overhead.

Note what these charts show. First-Class Mail pays for more than three-fourths of the institutional, or overhead, costs of the Postal Service—more than \$15 billion. It is by far the major contributor in this regard. If First-Class were to disappear, its contribution to overhead would have to be spread among the remaining mail; likewise, if third class volumes were lost.

Concerns—What Should We Be Worried About?

We—you and me and the folks in the Postal Service—should be worried about cost containment and whether service can be delivered as promised. And, we should be worried—at least a little bit—about whether pushing too hard for short-term gain might produce head aches downstream.

A fundamental concern, of course, is the common costs of the system, the institutional or overhead costs, which as figure 1 shows are about 36 percent of the total. If mail leaves the postal system, the attributable costs of that mail, in theory at least—although not in reality, I fear—leave, also. The institutional costs, however, remain. Since there are fewer pieces among which to spread the institutional costs, the unit per piece costs will increase.

For example, suppose you have 100 pieces of mail and overhead costs of \$1. Each piece of mail must recover one cent of overhead costs. If volume drops to 50 pieces but overhead costs remain at \$1, each piece must recover two cents. The overhead contribution per piece has doubled.

The Postal Service has rightly been concerned that alternative delivery of third-class mail could lead to a reduction in third-class volume and, thus, have a significant negative impact on its financial situation. But I believe that First-Class volume is also threatened. In the future, First-Class letters may, in the face of FAX, E-mail, electronic funds transfer, electronic banking,

and bill paying technological advances be as sensitive to service and price—both own price and that of alternatives—as third-class mail.

I think you can readily deduce from the numbers I have been throwing at you that even just a modest loss of First Class volume poses a greater potential threat to third class rates, than does a loss of third to First Class rates.

Let me say at this juncture that, while technology may threaten mail volume it can also generate new volume. For example, thanks to cable TV, I now receive one more bill and pay one more bill each month than was the case when I had to get up on the roof and jiggle a TV antenna. And, thanks to cable TV—and I do thank them for this, I no longer have to get up on the roof and jiggle that antenna!

I might also add, at this point, since I've been talking about overhead or institutional costs, that I've seen no evidence that the Postal Service has been able to limit growth in his area. As a matter of fact, it appears as though these supposedly fixed costs are actually growing at a faster clip than attributable costs. This should be a serious concern for all of us. If I am correct in my observation, it could mean that neither additional volumes, nor revenues from new ventures will result in a decrease in the unit overhead cost.

The Future

At the Rate Commission we have no crystal ball. What we do have is a commitment to the future of the Postal Service in America. In that vein we will continue to work with the Service in pursuing actions that will enable it to serve ever more effectively and efficiently the needs of the business community and American people, generally.

This means we will continue to do our best to analyze the data and evidence put before us, so that we make recommendations that are as fair and equitable as possible to all parties. It also means that we will continue an effort I initiated shortly after my arrival at the Commission to work with the Postal Governors and the Postmaster General to find ways to improve the current process.

Shortly after my arrival at the Commission, I had occasion to discuss with the Postmaster General and several Postal Governors the need to move forward, particularly to revisit some

recommendations of the Joint Task Force—of Governors and Commissioners—on Postal Ratemaking Report, issued in 1992. The Postal Service had shelved the Task Force Report while it embarked on its restructuring and downsizing efforts. My dialogue with the Postal Governors continued and just last month the Postal Service formally asked the Commission to consider seven Task Force Recommendations. The Commission immediately began a rulemaking proceeding to do just that. Earlier this year, we also reissued, at the request of the Postal Service, the rules for expedited treatment of requests for changes in Express Mail rates.

I am committed to following up on the Task Force and other recommendations wherever possible. Keep in mind, however, that the Postal Service, despite all the talk of the need for flexibility so it can compete, is a VERY large government granted monopoly that could easily, and without intent, do serious damage to foe and friend, alike, if left entirely to its own devices. Some of you may recall, for example, the E-COM effort of the early 1980's. Many letter shops were rightfully troubled that the Service was providing the supplies and manpower to print, fold, stuff and enter computer generated mail pieces into the First-Class mailstream all for only 26c—just 6c more than the cost of a stamp. Yesterday it was letter shops, today it is, perhaps, those guys in the brown trucks and some think, the presort bureaus, and tomorrow—who knows who might be the target of some new Postal Service initiative.

While I have no special insight on what the future holds, I do think the Postal Service is at a cross roads with no sign post. A major public policy question needs to be answered. It is both simple and complicated. It is this: "What do we want and what can we reasonably expect FROM our Postal Service?"

The Postal Service's historical mission is the collection, processing, transportation, and delivery of hard copy messages. Do we want the Postal Service to limit its focus to its historical mission—the delivery of hard-copy mail? That probably means little growth and perhaps eventual real downsizing. Or, do we want it to attempt to compete with the new technology and enter fields previously foreign to it? If it pursues new, competitive markets, will it be likely to compete successfully—and, if so, at whose expense?

There is a host of issues that must be considered if the Postal Service is to compete and embark on new ventures. How will its non-monopoly and monopoly activities interrelate?

Can a labor intensive organization operate in an entrepreneurial, capital intensive arena? And, since it takes \$1 billion dollars in profit to reduce the cost of a First-Class stamp by a penny—and, since slowing rate growth is what it is all about, are new ventures really worth the effort?

I read an article in the May 1 issue of INFORMATION WEEK about electronic postmarks—something that the Postal Service has expressed a great deal of interest in. The high end market potential is reported to be on the order of 500 million dollars at the turn of the century and it looks like the Postal Service will not have the field to itself. Just how much net profit can the Service reasonably expect if it competes in this arena?

Aside from these considerations, there are other obstacles to successful postal diversification.

The Postal Service's basic business is regulated, and, I would suggest, its occasional forays into unregulated areas have not proven particularly successful.

I sometimes wonder, when I hear postal officials suggest that all they need is the flexibility to change rates at will so they can compete, whether they need to do some reality checking—perhaps they need to take a careful look at their own international performance.

Moreover, it is not clear that the Postal Service has the legal authority to purchase existing businesses or to operate non-postal enterprises. And, the legislative gauntlet that they would have to run to get this authority, or other items on the Postmaster General's wish list, is rough and tumble.

If you'll permit me a "Gumpism"—my Mommy didn't always say it, but, "the legislative process IS like a box of chocolates...."

And most problematic, U.S. political tradition frowns on government competition with the private sector.

Now having said all this, let me leave you with a thought that will place my remarks in the proper perspective:

In 1927, motion picture mogul Harry M. Warner said "who the hell wants to hear actors talk?" So much for us experts!!

I want to thank you for listening. I would be happy to try and answer questions.

Dollar Amounts in Millions

Figure 1
R94-1 Total Revenue

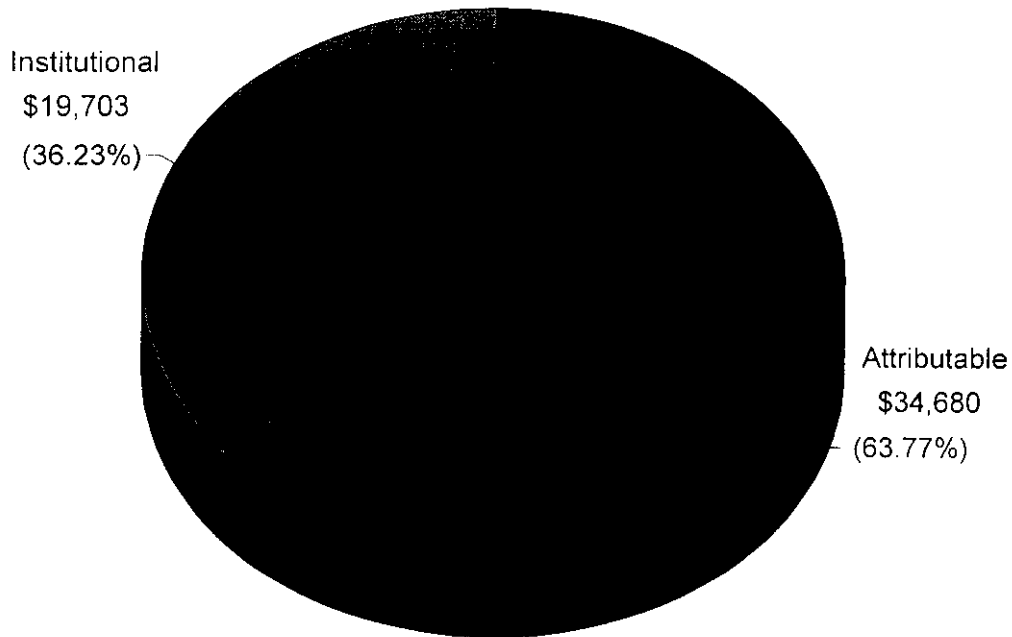
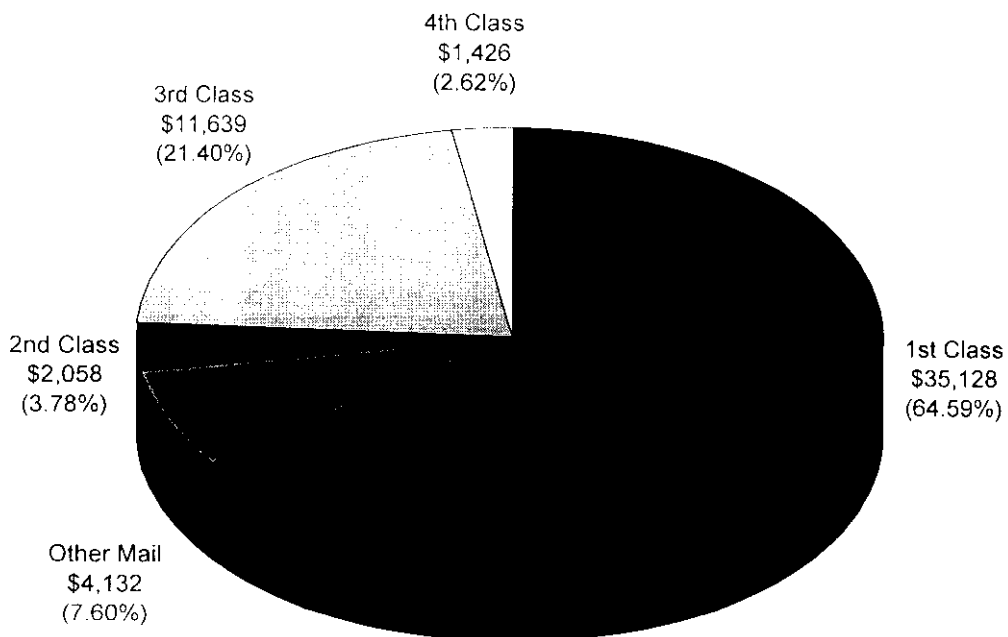


Figure 2
Revenue Shares



Dollar Amounts in Millions

Figure 3
Institutional Cost Shares

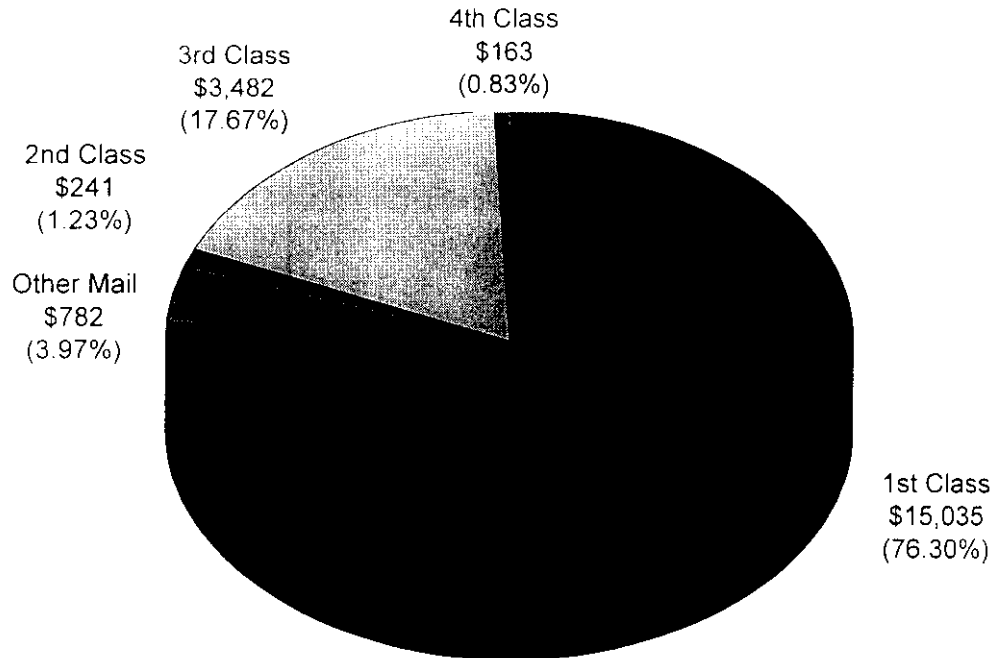


Figure 4
Cost Contribution for
First- and Third-Classes of Mail

	<u>% Volume</u>	<u>% Revenue</u>	<u>% of Cost Contribution</u>
First Class	53.91%	64.59%	76.30%
Third Class	38.88%	21.40%	17.67%
Totals	92.79%	85.99%	93.98%