BEFORE THE

COMMITTEE ON HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

"OUTSIDE THE BOX: REFORMING AND RENEWING THE POSTAL SERVICE, PART I – MAINTAINING SERVICES, REDUCING COSTS, AND INCREASING REVENUE THROUGH INNOVATION AND MODERNIZATION"

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TESTIMONY OF

JERRY CERASALE
SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS
DIRECT MARKETING ASSOCIATION, INC.
ON BEHALF OF
AFFORDABLE MAIL ALLIANCE
COALITION FOR A 21ST CENTURY POSTAL SERVICE
DIRECT MARKETING ASSOCIATION

Jerry Cerasale
Senior Vice President, Government Affairs
Direct Marketing Association, Inc.
1615 L Street, NW, Suite 1100
Washington, DC 20036
202/861-2423

Good morning, Senator Carper, Senator Coburn and members of the Committee, I am Jerry Cerasale, Senior Vice President for Government Affairs of the Direct Marketing Association, and I thank you for the opportunity to appear today on behalf of a united Postal Service customer community including the Affordable Mail Alliance, the Coalition for a 21st Century Postal Service, all the major postal customer trade associations, and the paper, printing and mail technology industries. Together, we are a $1.3 trillion industry that employs nearly 8 million private sector workers, and constitutes some 9% of GDP.

The Postal Service remains a vital communications and distribution channel for our nation's economy and the linchpin of the enormous industry which relies upon it. Yet, the Postal Service continues to struggle financially. Legislative change is indispensable.

As you know, taxpayers do not support the Postal Service. Rather, it is the business, nonprofit, and other mailers whose decisions to purchase postage pay the bills of the Postal Service. They account for approximately 80% of mail volume in all classes of mail and contribute 90% of the revenue of the U.S. Postal Service. Yet our industries have lost more than one million jobs since 2007. Many more are at stake

So, we are very pleased to have been invited to testify before you today. Given the urgency of the Postal Service's situation, we are encouraged that the Chairman and Ranking Member of this Committee remain invested in postal reform; we appreciate your leadership on this vital matter. As Senator Coburn stated, S. 1486 is a draft that hopefully would generate discussion on postal reform. It certainly has. The mailing industry stands ready to work with this Committee and the Congress to adopt legislation that continues a Postal Service supported by affordable and predictable postage rates upon which American citizens, our economy and the millions of employees in our industry rely.

We believe that the draft contains a number of constructive provisions that will be very useful to stabilizing the Postal Service's financial situation. Unfortunately, it also contains provisions that are so detrimental to the mailing industry and its supply chain that we must oppose the bill if included: 1) changes to the rate cap established under the

Postal Accountability and Enhancement Act of 2006 (PAEA); and 2) unrestricted, unchecked power handed to the Postal Service Governors to set rates.

As a bottom line, it is important to recognize that postage is not a tax. No one can force anyone to buy postage and mail. In today's competitive world, the market will be determinative. Raise postage rates too high, i.e., beyond inflation, and volume will suffer substantially.

Let me address a number of the specifics in the bill.

Health Benefits

PAEA has required postal customers to fund future postal retiree health benefits with a steep 10-year payment schedule averaging approximately $5.5 billion per year. As you know, the Postal Service has defaulted on these payments for the last two years and likely will default on a third payment at the end of this month. We believe the 40-year payment schedule for retiree health benefits contained in S. 1486 represents an appropriate solution. Such a schedule was in effect in 1971 for postal pensions under the Civil Service Retirement System and proved to be very successful.

The health benefit issue for the Postal Service is not confined to postal retirees. We have learned from the Postmaster General that the Postal Service and its employee organizations are negotiating a new health benefit program for postal employees and retirees within the Federal Employees Health Benefit Program run by OPM. Potential savings from any agreement could eliminate virtually all of the ~$50 billion unfunded retiree health benefit obligation of the Postal Service. It would also reduce the current employee annual obligation as well. We understand that any new program would cover only postal employees and retirees, would require those over 64 to enroll in Medicare Parts A, B and D, would mandate that OPM require the insurance companies in the new program to establish a Medicare Part D supplemental plan, and would mandate that OPM establish a postal blended rate for the new program. We encourage the Service and its employee organizations to reach an accord. Similarly, we support the principles in S. 1486 to create a postal health program and ask that any bargained agreement be included within the bill.

Postal Pensions

Postal customers, through the postage rates they pay, have been funding Postal Service employee pensions since July, 1971. Recently, the Office of Personnel Management (OPM) determined that postal customers have overfunded pension obligations for postal retirees under the Federal Employee Retirement System (FERS). That overpayment is in the billions of dollars, which means that the mailing community has contributed approximately 90% of those overpaid billions.

While customers should fund pension benefits for postal employees, they should not overfund them. The actual amount of the overfunding depends upon interest rates, timing and employee complement characteristics. S. 1486 would provide that postal employee characteristics be used to calculate any over funding or under funding of the FERS account, and that overfunded amounts be returned to USPS. We support both changes.

Postage

We have grave concerns about the rate setting provisions in S. 1486. Section 301 of the bill would grant the Board of Governors unilateral authority to set postage rates with an after-the-fact review through a weak complaint process at the Postal Regulatory Commission (PRC). This change prompts several serious issues:

- The after-the-fact complaint process at the Commission has no time limit, so rates could well go into effect long before a decision is reached – some complaint cases have taken years – and making the most appropriate remedy, i.e., refunds, completely unworkable: To whom would they go, and how would the Postal Service charge mailers who had underpaid in reliance upon incorrect rates?
- The burden of proof would shift to mailers, and the process would resemble the burdensome, expensive litigation wisely cast aside by Congress in PAEA;
- Since USPS holds a statutory monopoly over the distribution of Market Dominant products, the absence of a before-the-fact check invites abuse, even if inadvertent, providing ample reason why a more objective body should determine whether and how the ratesetting system should be updated; and

- Since the Postal Service is exempt from the antitrust, tax and other laws at both the federal and state levels, it should not in its Market Dominant categories be granted rate authority comparable to a business entity in a competitive environment

We are not aware of any other industry where Congress has granted the Board of an organization, having a statutory monopoly over a product and the delivery receptacle of that product, unilateral pricing authority on those products. We urge you not to create an unprecedented and virtually unregulated monopoly over letter mail that affects millions of American jobs, thousands of American organizations, and millions of beneficiaries or charitable causes. We do not believe this is good public policy, good for the economy or good for all who depend on affordable mail delivery.

For us, the CPI price cap on market dominant classes of mail remains a critical piece of any postal rate setting. The cap assures certainty and predictability in postage increases, leading to predictable mailer planning. Also, the cap is the incentive for the Postal Service to innovate, streamline operations and reduce costs. Without the cap, raising postage higher than inflation could easily become the norm during difficult times. We believe that the significant streamlining in operations that the Postal Service has already achieved is, to a large extent, due to the CPI cap on postage. Removing it would be a detriment to the Postal Service as short-term revenue increases would trump long-term mail volume retention. We are aware of studies that indicate mail is not price elastic—that mail would not leave the system due to postage increases. Executives of our members tell us otherwise. Technological changes are enormous, rapid and are coming at an ever increasing rate. They have, in fact, been gamechangers in the marketplace. They offer mailers new avenues to communicate with, and distribute to, current and potential customers and donors. Let me offer a few illustrations.

In Standard Mail, an executive in charge of a marketing campaign typically will review the predicted returns on investment (ROIs) from all of the options available, and distribute the company's available promotional funding according to the best advantage of that campaign. That executive will review the comparative ROIs frequently, sometimes on a weekly or even daily basis, and adjust among them as indicated. If postage rates go up, the ROI on mail empirically, and relative to the other avenues of communication, will change for the worse. Adjustments to reflect that, i.e., shifting from mail to other options, will occur. Moreover, those adjustments would especially reduce tprospecting mail—mail seeking new customers and donors—which has the lowest ROI. Thus, investment in the future would be the first mail to be eliminated harming the future viability of the Service.

In Periodicals Mail, higher postage rates would increase the economic pressure to move to digital delivery and to seek other forms of physical delivery of the product. The likelihood of higher than inflation postage increases will increase those efforts as the assurance of predictable postage increases is eliminated.

In First Class, the case is even more straightforward. On average, according to mailing executives, of every dollar spent on business First Class mail, paper, printing, content and other expenses total 35 cents. Postage is 65 cents. With printing costs having declined, and paper costs barely held even, over the past decade (in contrast to the steady upward track of postage), there is only one place to go if postage goes up—out of the mail and online. Ten years ago, if a mailing executive advised his or her Chief Financial Officer that the price of mail was going up, s/he would receive a matching boost of funds. Today, with other options available, the mailing executive will simply be directed to live within the existing budget. The result: more mail diverted online.

There has been a fairly steady march out of the mail and online. But all the First-Class Mail that could leave has not. Companies vary in how much mail has been taken out of the system. The industry rule of thumb is that roughly 25 – 27% of recipients will insist on continued paper communications. For most larger mailers 15% to 20% of First-Class Mail has been shifted to digital (granted for some, it can be as high as 55 or 60%) That leaves a very substantial spread between mail actually withdrawn and mail that could be withdrawn—a very substantial volume of mail.

Higher postage gives mailers an incentive to choose less expensive alternatives, and induces them to give incentives to their customers to accept digital rather than paper communications. Once a customer account is gone from paper, it's gone; it's not coming back. That will mean the loss not only of statements and bill payments, but several promotional pieces per year per account.

The CPI cap is a necessary provision for the future of the Postal Service and the customers it serves. The mailing industry includes suppliers to mailers, such as printers, paper manufacturers and technology providers. Those suppliers are a marketing team for the U.S. Mail since as mail volume grows, their business grows. Those suppliers tell us that even the possibility of a greater than inflation postage increase makes it much more difficult for them to "sell the mail." Postage stability is a key to finding new volume and retaining current volume. Without predictability in postage, the digital world of communications becomes more and more inviting.

In May, 2007, catalog mailers received a double digit postage increase. Catalog volumes plummeted 23 percent in the next year—a year in which other Standard Mail volume grew. Moreover, catalog postage revenue for the Postal Service, even with the double digit postage increase, dropped by 11 percent. Why? Contrary to the mail elasticity studies, catalog mail volume dropped by more than the postage increase. Why have those studies not picked up today's higher price elasticities? Recent rate increases have been limited to inflation. Postage increases above the rate of inflation may not be accurately explained by those studies. That can prove to be dangerous.

Prior to the 2007 double digit catalog postage increase, the Postal Service Board approved a significant purchase of flat-shaped mail processing equipment to improve the productivity of processing that mail, which includes catalogs. Sadly, the 2007 postage increase reduced flat-shaped mail volume to the extent that those flat-shaped mail processing machines could not and cannot be operated efficiently—there is not enough mail volume. These events created a significant amount of excess flat-shaped mail processing capacity. We urge Congress not to repeat this miscalculation. Postage increases above inflation will drive out significant mail volume.

Those factors are why a united postal customer community will vigorously fight any efforts of the Postal Service to break the CPI cap by filing an exigency postage rate case. The Congress should oppose it as well. An exigency increase will result in a short-term infusion of cash, as mailers adjust their plans to take more volume out of the system. We cannot gamble the future of the Postal Service on that potential short-term influx of cash. The stakes are too high.

I want to return to the excess flat-shaped mail processing capacity issue for a moment. There have been numerous and repeated calls to raise postage for "underwater" classes and products of mail,—eliminating any "underwater" or below-cost classes and products of mail. Those classes and products predominantly are flat-shaped mail. We believe that the underwater nature is due to Postal Service excess capacity. Last Congress the Senate passed S. 1789 that contained a provision asking for a study of the effect of excess capacity of the costs of flat-shaped mail. We believe that was a good compromise that should be continued.

New Postal Products

In order to survive in the 21st Century, the Postal Service must provide services that customers need at a price customers are willing and able to pay. The Service should be aggressively seeking to offer new products that meet customer needs. For postal related products, the Service should continue to poll its customers to discern the demand for new postal products that will enhance the ability of customers to improve their businesses.

As far as non-postal products are concerned, some caution is required. Postal Service employee expertise is collecting, sorting, transporting and delivery physical mail. Non-postal products do not fall within their expertise, and efforts to gain that expertise will reduce focus on efforts to improve performance dealing with postal products. If there is a discernible market need that is not being adequately met, the Service should find private sector business partners who can provide the requisite expertise. Moreover, the Service should be limited from unfairly competing with private sector businesses already offering products or services the Service may be considering providing.

The Service should be able to use experimental authority to test new products, some of which may fail. The Service should not be constrained with a short-term no-loss oversight of experimental offerings.

Postal Facilities

We commend the Postal Service for its efforts to right-size its processing and transportation network. They have accomplished a significant cost reduction in a short period of time without service disruptions. We support completion of these efforts. We do not understand the 2-year moratorium in S. 1486 in light of the significant closings that have already occurred without harming service. The financial viability of the Postal Service depends upon the ability of management to adjust its networks to meet the changing needs in the marketplace and mail volume. They should be granted the authority to accomplish that task.

Delivery Point Modernization

Since studies have indicated that there are significant cost savings to delivery point modernization, we believe that the Service should further assess it and the attitudes of citizens concerning any home delivery changes, and report to Congress within a reasonable period of time.

Delivery Days

Elimination of Saturday delivery has been very controversial; the mailing industry and its supply chain remains split over their willingness to accept a 5-day delivery week. We appreciate the compromise in S. 1486 that helps facilitate the growth of the Postal Service's most promising segment, parcels. We view the compromise as a constructive basis for further discussion.

The Postal Service should focus on increasing mail volume. It first should look very aggressively at removing barriers for customers to use the mail. In the past few years the Postal Service has placed many new requirements on business customers that necessitated reengineering the address placement on catalogs, new barcoding, and new demands on customers' IT systems in hopes of reducing costs of the Postal Service. Sadly, those costs keep rising at the same time the requirements increase the costs for mailers. And, in fact, mailers do not differentiate these "compliance" costs from rate increases: it all makes mailing more expensive and less competitive. All of those requirements should be reexamined by the Service in constant consultation with its customers.

In conclusion, postal reform legislation remains as urgent as it has been for the past several years. Postal Service financial uncertainty and potential exigent (above inflation) postage increases are undermining mailers' confidence in this communications channel. This threatens the long-term financial viability of a $65 billion per year entity. We urge you to act with all deliberate speed.

But we reiterate that changing the CPI cap and granting unrestricted, and unchecked, authority to the Board of Governors to increase postage rates are both unacceptable to the mailing community and its suppliers. We believe those provisions will drive away business and damage both the industry and the Postal Service. So, we encourage you to build upon the many positives in S. 1486, negotiated health benefit reform prime among them, to develop reform that will bring stability to postal finances without pushing volume out of the system and raising the specter of a bailout. Our community looks forward to working with you on this endeavor.

I thank you and look forward to any questions you may have.