

Before the
Special Panel on Postal Reform and Oversight
of the
Committee on Government Reform
United States House of Representatives

Prepared Statement of
Frederick W. Smith
Chairman, President, and Chief Executive Officer
FedEx Corporation

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FedEx supports modernization and transformation of the United States Postal Service. FedEx worked closely with the committee in the past to develop H.R. 22 and H.R. 4970, and we continue to believe that this legislation represents a sound and balanced update to the Postal Reorganization Act of 1970. For reasons well described in the recent report of the President's Commission on the Postal Service, the Postal Service must be transformed into a fundamentally more flexible and responsive organization if it is to survive and prosper in the shifting social, commercial, and technological conditions presented at the start of the twenty-first century. At the same time, the regulatory framework must be reshaped to protect and promote a universal postal service suited to the needs of citizens in the Information Age. At FedEx, we look forward to working with the committee in addressing these challenges.

I am testifying today on behalf of the management and over 200,000 employees and independent contractors who make up the FedEx family of companies. For them and for myself, I would like to thank the committee for this opportunity to present our views on reform of the nation's postal laws. I am keenly aware that many members of the committee have worked long

and hard to find a formula for postal modernization. Chairman Davis, Mr. Waxman, Mr. -Burton, and Mr. Davis of Illinois have been leaders in this bipartisan effort, and we at FedEx are grateful for their contributions. Chairman McHugh, however, deserves the particular thanks of all participants in this process. As the prime mover of postal reform for eight long years, he has combined the patience of Job with the wisdom of Solomon and the eternal optimism of a Cubs fan. It is a particular pleasure to return to the topic of postal reform and find Chairman McHugh still holding the gavel.

In four previous appearances before the committee, I have discussed in some detail the key concepts and specific provisions found in past legislative proposals, including the inherent difficulties in competition between public and private enterprises, appropriate mechanisms for ensuring universal service, division of postal products into non-competitive and competitive categories, reasonable limits on pricing flexibility for each category of products, proper bounds for market tests of new postal products, the scope and administration of the postal monopoly, equitable access to the mailbox for all operators, equal application of non-postal laws to the Postal Service and private companies, impartial administration of postal laws, Postal Service entry into new markets, the role of the Board of Governors, and inadequacies in U.S. international postal policy and the Universal Postal Union. I am happy to acknowledge that the last version of this legislation (H.R. 4970) addressed most of the points raised in my testimony. I will be glad to comment in similar detail on a new legislative proposal when it is ready.

Today, I would like to focus more generally on how the evolving commercial environment has impelled profound changes in the way we at FedEx do business and why, in my view, similarly elemental changes must be considered for the Postal Service and the postal regulatory framework generally.

THE TRANSFORMATION OF FEDEX:

FROM DOMESTIC EXPRESS TO GLOBAL TRANSPORTATION SOLUTIONS

As the Postal Service, the Presidential Commission, the Comptroller General, and many others have pointed out, the delivery services sector is changing rapidly and fundamentally. Postmaster General Potter has rightly called this a period of “structural change.” For the Postal Service, the key barometer of change is its core product, First-Class Mail. First-Class Mail has dropped by more than 4 percent since 2000. Moreover, as Governor Fineman, chairman of the Postal Service's Board of Governors, has pointed out, the product mix of the Postal Service is shifting inexorably. This year First-Class Mail crossed a major psychological barrier as it fell to less than half of total mail volume (49 percent, as opposed to 50 percent in 2000).

Virtually all observers have emphasized to this committee that the Postal Service needs greater flexibility in operations and pricing. I agree with these prescriptions. To underscore this point, I would like to describe briefly what has happened at FedEx since I last testified in March 2000.

Like the Postal Service, we have been challenged by the decline of old technologies, the rise of security concerns, and the turmoil of economic dislocations. Looking back, the decade prior to 2000 was a golden age. Our express shipments increased by almost 150 percent, more

than 9 percent per year. During the same period, First-Class Mail grew at an average annual rate of 1.5 percent. Then, from June 2000 to June 2003, our domestic express shipments *declined* by more than 8 percent. This decline is almost three times the decline in First-Class Mail over the same period.

In response, we initiated a tough program of cost containment. We froze hiring in most areas, reduced bonuses, cut discretionary spending, and lowered capital spending. This year FedEx Express offered voluntary early retirement and voluntary severance incentives to many employees based in the United States. As a result of such measures, FedEx Express has significantly fewer employees today than it did in 2000. And I am happy to report that during this difficult period FedEx Express has not had to lay off a single employee.

Cost reduction, however, is only the beginning of the story. In 2000, we extended the FedEx brand to a broad and integrated range of ground, freight, and logistics services. This initiative represented far more than a “rebranding” exercise. We have moved FedEx's center of gravity away from the familiar world of overnight express services. Today, the FedEx family of operating companies consists of FedEx Express, FedEx Ground, FedEx Freight, FedEx Custom Critical, FedEx Trade Networks, and FedEx Supply Chain Services. We have also increased our participation in global markets enormously. Today, FedEx delivers shipments of any size and related information to virtually any place in the world in a range of circumstances best suited to the needs of our customers. In essence, our business has become one of enabling customers to optimize global supply chains.

This transformation has already had dramatic consequences for our company. In three short years, the share of corporate revenues provided by the U.S. domestic express package

business has dropped from 55 percent to 41 percent. FedEx International Priority package revenue has risen from one-quarter to one-third of our overall express business. In short, the FedEx that I represent today is not the same FedEx that I represented in 2000. This transformation is still unfolding. We are continually looking ahead for new ideas and new partners that will allow us to better meet the demands of an ever changing marketplace -- before someone else beats us to it.

THE TRANSFORMATION OF THE POSTAL SERVICE:

GREATER FLEXIBILITY AND STRONGER INCENTIVES

Under the leadership of Postmaster General Potter, the Postal Service has made truly impressive strides in cost containment. In other areas as well, the Postal Service is carrying through on the many improvements outlined in the Transformation Plan. I am very pleased to commend such progress by a fellow CEO in our business.

For the Postal Service, however, as for FedEx, I believe that cost containment and incremental operational improvements will prove insufficient to ensure survival. If the Postal Service is to prosper over the next decades, it will require profound institutional transformation. The gale force winds reshaping global commerce are blowing at Postal Service headquarters no less than at our own. The implications of these forces must be faced squarely by Congress, mailers, and the management and employees of the Postal Service.

Peter Drucker has estimated that “[t]he Information Revolution is now at the point at which the Industrial Revolution was in the early 1820s.” According to Drucker, the computer and other gadgets of the Information Revolution have so far done little more than improve

processes that were already going on. The real revolution is only just getting underway. It is the internet, says Drucker, that is destined to reshape life in the global village in the same way that the railroad reshaped all aspects of society in the middle of the nineteenth century.

In broad terms, Professor Drucker is surely correct. The influence of the internet is already so pervasive that it is difficult to recall how recently it was introduced into the mainstream of society. The majority of American households were not connected to the internet until late 2001. Today, some three-quarters of American households are connected in major cities. Even so, outside the wealthiest neighborhoods and college dorms, broadband connection to the household is still the exception. And outside the United States, where the internet is less ubiquitous, almost all nations have made expanding internet connectivity a top governmental priority. We are only just beginning to see the implications of the internet for society in general and for the Postal Service in particular.

Viewed from this perspective, the future of first class correspondence must be regarded as extremely precarious. Proliferation of high speed connections will likely also reduce demand for the physical distribution of advertisements, catalogs, and magazines. It takes no crystal ball to recognize that such shifts in the demand for traditional postal services will necessitate a radically different Postal Service organization. How different will depend upon on how well the Postal Service responds.

As presently organized and regulated, the Postal Service is ill-equipped to undertake the needed transformation. As you know, in the last two years, FedEx has begun supplying air transportation for several Postal Service products. This has been our first extensive working relationship with the Postal Service, and we have been extremely impressed with the

professionalism of Postal Service managers and the scale of its operations. At the same time, this relationship has allowed to us to understand better the institutional restraints handicapping the Postal Service. So I can say now with the benefit of first hand experience that it is the system, not the people, that poses the greatest obstacle to the future of the Postal Service.

When the Postmaster General says, "Management needs the flexibility to manage" he is not repeating a pious nostrum; he is identifying the basic tool necessary for the survival of the Postal Service. Likewise, in an earlier hearing, Governor Fineman insightfully put his finger on a second critical element of postal transformation: incentives. The Postal Service needs both the flexibility to adapt to the demands of its customers and the incentives to do so. These are the two necessary ingredients to transformation of the Postal Service.

Consider how difficult would have been the changes at FedEx that I have just described without the flexibility and incentives enjoyed by a private company in a competitive market. Imagine that, three years ago, the directors of FedEx were replaced by a politically appointed board of governors. Imagine that FedEx was required to obtain regulatory approval before offering new services. Imagine that we were forbidden from consolidating offices and operational facilities in response to shifting demand. And, worst of all, imagine we are granted a legal monopoly over domestic express shipments, a "privilege" that would send a loud and clear message to our employees: "Relax, FedEx will get the business for now whether you satisfy the customer or not." Under such circumstances, can anyone imagine that FedEx -- even with its talented and dedicated management team -- could have managed the changes of the last three years? I cannot.

The Presidential Commission urged the Postal Service to “[apply] the best practices of the private sector to delivering the nation’s mail.” No doubt, this is the right objective, but it is an objective that can be achieved only if the Postal Service has the management flexibility and incentives of the private sector. If the Postal Service is not granted such flexibility, and lacks such incentives, then the probable fate of the Postal Service is to wither and decline. The market is changing too quickly to predict any other outcome with assurance.

THE TRANSFORMATION OF POSTAL REGULATION:

THE FUTURE OF UNIVERSAL POSTAL SERVICE AND FAIR COMPETITION

Of course, as members of the committee are aware, imbuing postal management with flexibility and incentives sufficient to emulate the “best practices of the private sector” sounds good in theory, but it also raises many thorny policy issues that cannot be dismissed out of hand. Many will ask, what if the Postal Service uses managerial flexibility to close a post office in my town? To cross subsidize competitive services from monopoly revenues? To curtail delivery services in my neighborhood? To raise postage rates critical to my business? To go into competition with my company? Indeed, suppose the Postal Service uses managerial flexibility to pursue a disastrously unwise business venture?

In the first place, it should be noted that none of these objections truly obviates the basic case for conferring on the Postal Service greater flexibility and stronger incentives. In times of fundamental change -- such as we are living through now -- the ability to respond and restructure is necessary to institutional survival. The whole purpose of the changes at FedEx has been to enable us to better serve the present and future needs of as many customers as possible by

reducing costs and improving services. So, likewise, there is no reason to believe that the Postal Service, faced with proper incentives, will abandon customers or curtail needed services. On the contrary, there is every reason to believe that the Postal Service can and will improve the level of services provided.

I realize, however, that this general observation is hardly adequate. Many will argue that postal service remains so important to the country that we must not merely provide proper incentives for continued universal service, we must *guarantee* universal service at an affordable rate for all Americans.

I agree. Let me be clear. I support universal postal service. Every citizen in every part of the nation should have access to basic, affordable postal service. There is no reason that I can think of why the basic stamp price cannot remain uniform and affordable throughout the nation for as far into the future as we can see. "Should the United States assure universal postal service?" is not the question so far as I am concerned. But "What is the most efficient way for the United States to guarantee a level of universal postal service consistent with our national needs?" is a legitimate question that proponents of universal service need to address seriously and quantitatively. More particularly, any legislation must address the corollary question: "How can we give the Postal Service the maximum level of managerial flexibility and appropriate incentives while ensuring a level of universal service appropriate to the needs of the public?"

The other great specter raised by managerial flexibility at the Postal Service is the shadow of unfair competition. As I have said many times, FedEx will not support a bill that allows the Postal Service to raise rates in non-competitive markets and use the funds to lower rates in competitive markets. Nor will we will support a bill that allows the Postal Service to use

governmental status for commercial gain or convert assets of the United States into cash for buying into competitive markets. The “firewalls” found in past reform proposals remain crucial to our support for postal legislation. At the same time, FedEx has supported the right of the Postal Service to compete fairly. Indeed, I remind the committee that in years past FedEx was one of the lone voices arguing that over the long term Postal Service management needed the flexibility to enter new markets reasonably related to current business, a managerial option Postmaster General Potter pointed to in his recent testimony. In the past, we accepted this possibility provided the Postal Service competed on a level playing field and maintained structural separation between postal and non-postal businesses. We still think this is a concept worth considering.

While all reasonable persons must concede that concerns over the quality of universal service and fair competition are both fundamental and legitimate, these concerns are not irreconcilable with giving the Postal Service the managerial flexibility and incentives necessary for fundamental transformation. Indeed, I firmly believe that postal transformation, managed correctly, can *improve* the quality of universal service available to all Americans. I also firmly believe that postal transformation can be integrated with regulatory improvements that will, without a doubt, provide *more effective* safeguards against unfair competition than exist under current law.

To take the necessary steps with such assurance, we need a transformation of the postal regulatory framework comparable to that which postal operators must undergo. In his recent testimony, Commissioner Omas, chairman of the Postal Rate Commission, put his finger on the key principle running like a thread through the Presidential Commission's report: strict

separation of managerial and government functions. The Postal Rate Commission, or its successor, must make the necessary judgments about public interest goals which the Postal Service -- and any other providers of basic postal services -- must fulfill. After that, Postal Service management should be free to manage to the public interest objectives set by the Commission.

In this regard, the Presidential Commission has made several useful suggestions and some less useful. The Commission proposed that the postal regulator should be authorized to make adjustments in the scope of universal service and the breadth of the postal monopoly. In my judgment, the scope of universal service is both a political and a technical issue. The broad parameters of universal service embody social policy. They should be determined by Congress in legislation, not by a regulator. Precisely how these parameters are applied in a given community -- for example, whether the time has come to close a post office that has been maintained for largely social reasons -- is a more technical matter that should be committed to the regulator.

The postal monopoly is a different animal. Whether or not universal service should be funded in part by a postal monopoly is a decision for Congress to make. Personally, I think that granting a monopoly to any commercial enterprise is a mistake. A monopoly induces inefficiencies and disincentives that outweigh any possible benefit. The biggest victim of the postal monopoly is the Postal Service. Nonetheless, whether to employ a monopoly as a funding mechanism is a Congressional decision, much like a decision on tax policy. Assuming Congress approves the continued use of a postal monopoly, it should, at a minimum, put in place a statutory ceiling such as that proposed in H.R. 4970. Underneath this ceiling, the breadth of the

monopoly needed to support a given level of universal service is a technical, economic judgment that is best committed to an impartial and expert regulator. The basic rule should be that the postal monopoly should be no more extensive than needed to finance universal service.

The Presidential Commission also proposed giving the postal regulator more questionable powers. While I agree that the postal regulator should be able to limit the total revenue generated from non-competitive postal markets, I do not see any reason why the regulator should second guess postal management's decisions about one particular cost input, the wages of employees. Once the regulator has put reasonable limits on non-competitive postage rates, using price caps or some other means, the Postal Service should be free to manage its cost structure like any other commercial organization. The same may be said about regulatory oversight of retained earnings, another proposal by the Presidential Commission. In my view, the appropriate level of retained earnings should be determined by the managers and owners of the Postal Service, not by a regulator whose task is to ensure the standards and affordability of universal service.

The principle that managerial and governmental functions should be clearly separated also provides the proper framework for addressing issues raised by last year's postal financing law. Since military pensions are clearly a responsibility of government, not an operational expense, they should be a liability of Treasury, not the Postal Service. Similarly, since structural transformation of a commercial organization like the Postal Service is more a managerial than a governmental problem, introducing Congressional control over an escrow account, funded by possibly unnecessary rate increases, may not be the best way to facilitate the long term survival and prosperity of the Postal Service. The Presidential Commission urged Congress to consider

legislation to make the USPS Board more business-like and less political. While I do not necessarily agree with the specifics of the Commission's proposal to reorganize the Board, the Commission did identify the proper focus for Congress: modernize the USPS Board and then let it oversee the transformation process.

CONCLUSION

The Postal Service's April 2002 Transformation Plan began, "We live in challenging times." Indeed we do. At FedEx, in the last three years, we have put enormous effort into understanding these challenges and transforming our company to meet them. As many observers have pointed out, it is time for Congress to undertake a transformation of the Postal Service and the postal regulatory framework that is at least as fundamental as that underway at FedEx. We look forward to working constructively with the committee and with the Postal Service to make this transition a success for both the Postal Service and for the nation.

Thank you.