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THE STRANGE STORY OF POSTAL REFORM

An Article Prepared by

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This article should be of interest to the Congress, the Executive Office of the President, senior management of the Postal Service, the Academy, and the private sector. It is a sequel to Comarow's November 2006 essay, "The U.S. Postal Service is a Government Corporation: So What?," his September 2006 essay, "The Postal Conundrum," and to his April 2006 essay, "How Not to Reform Government."

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THE STRANGE STORY OF POSTAL REFORM

On December 20, 2006, in the dying hours of the 109^{th} Congress, the Postal Accountability and Enhancement Act (P.L. 109-435), was signed into law. The House and Senate bills, H.R. 22 and S. 662, had been melded into the statute with no fundamental change.

Supported by most mailers, the bills had been unanimously opposed by the Postal Service Board of Governors. On September 24, 2004 and on August 2, 2005, and in a number of conferences, the Board and postal management had expressed severe and specific doubts about the bills, to no avail. Accordingly, on September 13, 2005, the Board informed the relevant committees that, despite providing needed financial relief, the bills were so bad that the Postal Service would be better off under existing law. The Governors' primary concern was an unprecedented assignment of authority to the newly-named Postal Regulatory Commission.

Under the Act, as the Board feared, PRC will play a significant role in defining universal service, delivery frequency, service standards, and network configuration. These public policy issues are the business of those who run an agency, not a regulator. PRC will have final authority on rates, except competitive products (Express Mail, etc.) which represent eleven percent of postal revenues. Even those would come under PRC scrutiny and corrective action. The major reaction to the Board's concerns was an intemperate (and questionable) statement from Senators Collins and Carper assailing the Board for breaking its promise at the last minute. "The Postal Service appears to have sunk to a new low," they said.

Next to take a dim view of the bills were most members of the President's own commission on postal reform. The Commission ducked the fact that the Postal Service had little control over rates and wages, but its July 31, 2003 report contained a large number of practical recommendations ignored by the Administration and Congress. Presidential commissions do their job and disappear. This commission was different. On February 7, 2006, seven of its nine members, on their own initiative, signed a letter to Congressional leaders and the relevant committees stating that

> Our concern is that the proposed legislation goes too far in transforming the regulator by giving it powers that will limit even further, rather than increase, the ability of the postal service to operate like a business. Giving the regulator the ability to receive, adjudicate and order remedies on virtually any complaint on any action the Postal Service takes essentially transfers oversight and operational authority from the Board of Governors and management to the regulator. Such an approach is likely to tie the Postal Service up in endless administrative proceedings and effectively preclude them from making the significant changes they must make to meet the daunting challenges that lie ahead. This is a governance model that simply won't work.

Like the Board's September 13, 2005 letter, this too fell into a black hole, and so the Postal Accountability and Enhancement Act was passed by unanimous consent in the Senate, and almost so in the House. With few exceptions, members had little or no understanding of the bills' potential for mischief. The House did have time, however, to slip in what the reliable Business Mailers Review termed "a little pork," inserting these amendments: Window hours at a branch of the Fairpoint Harbor Post Office, OH, may not be reduced below those in effect December 1, 2005. Single ZIP codes must be assigned for Auburn Township, OH; Hanahan, SC; Bradbury, CA; and Discovery Bay, CA.

I turn now to the reactions of mailers, whose success or even existence may depend upon an effective Postal Service, and from competitors, who stand to gain from a weakened Postal Service. A typical comment from a major mailer association, "The USPS has gained a great deal under the new law." From the editor of a mailers' newsletter, an astonishing claim: "It will make the rate-setting process similar to UPS and FedEx and DHL." From the National Newspaper Association, whose members compete fiercely with advertising mailers: "The most favorable postal legislation for newspapers in three decades." Perhaps both mailers and competitors were confused by the Senate Committee's press release, asserting that the Act would give the Postal Service "the same ability as any other business has to change prices whenever it needs to do so. But . . . the legislation would ensure that price increases be kept below an inflation-based ceiling." What businesses are required to keep prices below the rate of inflation?

Postmaster General Jack Potter, a world-class executive, had no choice but to deal with this fait accompli in a positive way: "The new law could not have come at a better time. The Postal Service has never been stronger, and the law enables us to build on our successes." Some observers were surprised, but surely they could not expect him to say, "We're stuck with a bad law." Potter must make it work, inspiring his workforce to meet the challenges of the statute.

Some mailers who publicly supported this "reform" privately expressed severe misgivings. Some said they needed rate relief, and that the bad parts of the bills could be taken care of in later sessions. Others said that their associations or companies were so committed that it wasn't possible "to throw the engine into reverse." In general, they expected three main benefits from this legislation. First, they had been overpaying pension benefits for many years. These had been placed in an escrow account established by Congress. Mailers thought that those funds would be returned to them in the form of lower rates. That will not happen.

Instead, the Act eliminates the escrow payments required by P.L. 108-18, but requires that mailers pay \$5.4 billion to \$5.8 billion every year for ten years into a Retiree Health Benefits Fund. This may bode well for the future, but it is hardly the relief that mailers expected. The projected net loss for 2007 is \$5.2 billion, which raises the revenue requirement. The present rate case is expected to increase rates, on average, over eight percent. It is also possible that a future Congress may alter these arrangements.

Mailers supported the legislation for a second reason. The Administration, wrapped in a cynical cloak of "budget neutrality," insisted that the Postal Service must pay for pension costs due for its retirees' prior military service. No other government agency has been so burdened, nor is the private sector. Finally, the Administration backed down; the Act does return the military retirement portion of veterans' pensions to the Treasury. As a government corporation, supported by customer revenues, not taxes, it was outrageous to tax postal customers for costs having nothing to do with the mails. As one mailer put it, "Great, Bush agreed to stop picking our pockets."

The third reason mailers lobbied for this Act was to obtain a rate cap that would hold price increases for non-competitive products under the rate of inflation. This may not work, since labor arbitrators, who decide wage levels, are not bound by the rate cap. Their awards, states the law, are "conclusive and binding." Since wages amount to nearly four-fifths of postal costs, neither the PRC nor the Board of Governors really set rates. It is mainly the arbitrator. The sound and fury at PRC hearings deal with the remaining one-fifth of costs.

Advocates of the Act point to other provisions that may benefit mailers, such as the Postal Service's ability to change mail classifications, and its right to "bank" a portion of its unused prerogative to raise rates. These and the benefits described above may have merit, but they don't help hold rates down, they tend to raise them. The escrow payments will continue for ten years unless the law is amended. The military pension provision corrects an injustice; Treasury will pay for the military part of pensions, and the money already paid will go back to the Postal Service over the next ten years. The rate cap may or may not influence the arbitrator's award. (The National Association of Letter Carriers is gearing up for arbitration, perhaps because it won a huge award in its last arbitration case. On February 8, the rural carriers' union members rejected the December 8, 2006 contract reached by their leaders and will also go to arbitration unless the contract is renegotiated and ratified.)

To achieve these mixed results, Congress and mailers spurned the judgments of the Board of Governors and the seven members of the President's Commission. Whether one side or the other is clearly right may never be settled, but here are some of the Act's provisions. Their total weight should appall anyone who has observed or experienced the crippling effects of over-regulation.

The Postal Regulatory Commission shall:

- Review each nonpostal service offered by the Postal Service and determine whether that service shall continue.

- Establish a modern system for regulating rates and classes for market-dominated products.

- Establish a procedure to adjust rates on an expedited basis.

- Review the system for regulating rates and classes for market-dominant products to determine if it is achieving its objectives.

- Promulgate regulations to prohibit subsidization of competitive products by market-dominant products; ensure that each competitive product covers attributable costs; ensure that all competitive products collectively cover an appropriate share of institutional costs.

- Determine whether the institutional costs contribution requirement should be retained, modified, or eliminated.

- Prescribe the content and form of the public reports to be provided by the Postal Service.

- Provide for public comment on all Postal Service reports and determine, in writing, their state of compliance.

- Evaluate whether the Postal Service has met the goals established under the Act regarding the protection or promotion of public policy objectives.

- Establish the accounting practices and principles to be used by the Postal Service, and direct it to submit to the PRC annual and any other periodic reports the PRC may require.

- Submit a report to Congress concerning operations of the Act and recommendations for improvements.

- Recommend to Congress and the President changes to universal service, the monopoly, and access to mailboxes; estimate the costs of universal service, analyze the likely benefit of the monopoly to sustain universal service.

The Postal Service shall:

- In consultation with the PRC, establish a set of service standards for market-dominant products to enhance the value of postal services, to reasonably assure delivery reliability, speed, and frequency, and to provide a system of objective performance measurements for each market-dominant product.

- In conjunction with the PRC, submit to Congress a plan for meeting these standards, including information on performance goals, changes to the network, and a description of the long-term vision for rationalizing the postal infrastructure and workforce.

- Report to Congress on how postal decisions impact rationalization plans, including a comprehensive plan for reemployment assistance, and a plan, developed in consultation with the Office of Personnel Management, for early retirement offers.

- Submit to PRC a detailed report on the rationale for any new workshare discount.

- Establish rates and classes for competitive products.

- Submit to the PRC a report which analyzes costs, revenues, rates, and quality of service, using methodologies prescribed by the PRC, to demonstrate that all products comply with the Act. Include all information on workshare discounts provided to market-dominant products. (Inspector General audits.)

- File with the PRC reports as required by the Securities and Exchange Commission Forms 10-Q, 10-K, and 8-K, including pension and post-retirement health obligations.

- Obtain an opinion from an independent auditor of the information provided with all financial reports.

- Report to Congress and the Office of Personnel Management any postal bonuses and compensation that exceed the Vice President's.

- Report to Congress steps to be taken to improve workplace safety.

- Report to Congress and the President on the extent to which women and minorities are represented in supervisory and management positions.

- Report to Congress and the President the number and value of contracts and subcontracts entered into with women, minorities, and small businesses.

- In conjunction with PRC, report to Congress and the President on the quality, accuracy, and completeness of information used in determining direct and indirect postal costs attributable to periodicals, and opportunities for more efficient collection, handling, transportation, or delivery of periodicals, including pricing incentives.

The Comptroller General shall:

- Report to Congress and the President, building upon the report the 2002 Presidential Commission, evaluating in-depth options and strategies for long-term structural and operational reforms.

The Office of Personnel Management shall:

- Provide data to facilitate the Postal Service's report on its pension and post-retirement health obligations.

- Determine the postal surplus or supplemental liability as of September 30, 2006 regarding CSRS, and determine surpluses or liabilities for each fiscal year up to September 30, 2038. If a liability remains after FY 2017, establish an amortization schedule to ensure liquidation of the liability. (USPS may request review by the PRC, and by an independent actuary).

The Secretary of the Treasury shall:

- Submit to the PRC recommendations regarding the Postal Service's accounting practices and principles; value of postal assets, liabilities related to providing competitive products; prevention of the subsidization of competitive products by market-dominant products; and determining the assumed Federal income tax on competitive products.

The Federal Trade Commission shall:

- Report to Congress, the President, and the PRC Federal and State laws that apply differently to the Postal Service with respect to competitive services, including recommendations to resolve legal differences. The report shall include input from other Federal agencies, mailers, competitors and the general public.

The Inspector General shall:

- Report to Congress and the Postal Service assessing any progress to improve workplace safety.

The foregoing is a very simplified and selective summary. For a real treat, read the Act. If such regulatory demands and constraints were proposed for private industry, their representatives would claim that they could not possibly exercise essential management responsibilities. This claim would be supported by OMB's regulatory oversight group. To do their jobs, managers need a fair degree of flexibility and control over prices, wages, and more. On November 11, 2006, Treasury Secretary Henry M. Paulson, Jr., said to the Economic Club of New York, "Excessive regulation slows innovation, imposes needless costs on investors, and stifles competitiveness and job creation." He was focusing on the private sector, but it would be irrational to believe that overregulation would not have the same effect on government executives, especially those who are pressed to employ business principles and practices.

In April 2001, the Government Accountability Office placed the Postal Service on its High Risk List, warning of a "death spiral" if its business model did not provide "incentives and flexibilities" essential to running the organization. Its experienced and competent staff repeated these warnings in report after report. Comptroller General David Walker's November 17, 2006 letter to "Congressional Leadership" stated, "The Postal Service's...business model is increasingly outmoded....comprehensive postal reform legislation is needed to provide the necessary incentives and flexibilities needed for the Service to transition to a modernized business model so that it can continue providing high-quality, universal postal services."

On that date, few believed that the bills being considered would be enacted and signed in the face of a threatened veto. Long shots occasionally win horse races; thirty-three days later, P.L. 109-435 became law, and GAO promptly removed the Postal Service from its High Risk List. GAO gave specific reasons for its decision: Postal Service progress in addressing its financial and capital challenges, improved financial reporting, paying off its debt, and more. All true, but the decision was silent on any improvement in the business model, GAO's core concern for six years.

I believe that retaining the Postal Service on the High Risk list would constitute a judgment that the Act failed to provide a better business model. Someone in Congress may have been uneasy about this; Sec. 710(a) requires a GAO report, in five years, on the business model. David Walker is the most proactive Comptroller General I've observed since the legendary Elmer Staats in the 1960s and 1970s, but there are limits to what he can say to his masters.

The Postal Service is a government corporation, one of eighteen. These are customer-supported agencies, not taxpayer supported. In every case but the Postal Service, their commissions or boards set prices, subject to due process procedures and appeal rights. Except for the Postal Service, workers in these corporations are paid by public officials as authorized by law. Binding arbitration has never been required of any Federal agency.

The Institute for Research on the Economics of Taxation noted, in its October 11, 2006 Congressional Advisory:

> Wages and benefits per postal-employee workyear averaged $65,636 in 2005. Although the law says that postal employees should receive wages and benefits comparable to what they could earn in the private sector, the majority of economic studies examining the issue have concluded that a postal pay premium of 20% - 25% exists if just wages are counted and about 35% if the Service's very generous benefits are also included. This is an average, of course, and does not apply to all postal workers. Above-market wages and benefits help explain why such a large portion of the Postal Service's total costs are labor related. The postal pay premium implies billions of dollars annually in above-market labor costs, which are passed on to mail users in higher postage rates (several cents on every letter).

Under the 2006 Act, pension and health benefits continue to be set by Congress. Closing or merging facilities will remain a daunting prospect. As noted above, within two years, the PRC will recommend such changes to universal service, the monopoly, and mailbox access "as the Commission considers appropriate." Within eighteen months, it will create a new system to set rates.

The legislative history of the 1970 Postal Reorganization Act is sprinkled with words like "businesslike," and "efficiency." The House Committee Report that year stated: "H.R. 17070 is designed to prevent...wastefulness in postal matters." We must require, it said, "postal management to operate efficiently and economically." Members chanted this mantra for thirty-five years while making it impossible for the Postal Service to comply. Despite some serious shortcomings over the years, postal managers have accomplished a great deal, even if handcuffed. If the nation's best executives were somehow convinced to take on every top postal position, they could not comply with the law's mandate for efficiency. They might even fail, as some excellent private sector executives have faltered in Postal Service positions.

I have contended in other Academy papers that good men and women can make a dysfunctional organization work, albeit with difficulty. I may have to eat my words in the context of postal reform. Far from giving managers reasonable flexibility, P.L. 109-435 imposes further constraints and punitive provisions. One grotesque section permits PRC to fine the Postal Service, without limit, if its officers defy PRC orders. Thus, mailers would pay for postal executives' blunders or recalcitrance.

Implementing P. L. 109-435 will be extraordinarily difficult, even if all parties tackle the job in a cooperative spirit. That will require a degree of statesmanship seldom seen among the conflicting forces in the postal community. The most critical dialogue will be between the PRC and the Postal Service. Mailers should recognize that if it is formal and adversarial, the Postal Service will end up coping with a sclerotic network, one that will weaken over time, with ill effects on all who depend upon it.

There is reason to hope that won't happen. Jack Potter will obviously try to avoid that result. Chairman Dan Gregory Blair was senior counsel of the Senate Governmental Affairs Committee. He knows a lot about the Postal Service, and has a deserved reputation for a thoughtful and moderate approach. Plus this: His experience as OPM's deputy director is bound to sensitize him to the need for flexibility in running complex organizations.

As matters stand, PRC is not capable of implementing the Act. It will enlarge its staff and probably engage consultants. The same is true of the Postal Service. Recruiting the right people for some of these specialized functions will be difficult and expensive. The other Federal agencies tasked under the Act, unfamiliar with complex postal issues, also confront challenges. My main concern, however, is not the heavy expense of implementation, but the drag that P.L. 109-435 will exert on those charged with running the Postal Service. Most of the Act's strictures have nothing to do with delivering the mail. They benefit or placate specific interests, based upon an unfortunate level of distrust. Only this can explain the total rejection of the Board's views, and the lack of any response to the seven Presidential Commission members.

How did twelve years of effort come to such a pass? Perhaps a brief personal history of the major events leading up to P.L. 109-435 may one day serve some purpose to stakeholders and scholars, if not to Congress. The story begins in April 1967, when

President Johnson, at the urging of Postmaster General Lawrence O'Brien, created the Kappel Commission to study the old Post Office Department. O'Brien saw it as a foundering, wasteful, and in many ways, corrupt agency. The Commission comprised six heads of major corporations such as AT&T, General Electric, and Bank of America; Harvard's business school dean; the president of the AFL-CIO; and two distinguished Democrats. I was its Executive Director.

In June 1968, the Commission recommended that the department should be removed from the Cabinet, made self-supporting and patronage-free, and directed by a presidentially-appointed Board of Directors vested with strong management authority, including control over wages and prices within due process and legal limits. Since over 60,000 postmaster and rural carrier jobs, and other political plums, were at the disposal of the President's party, the politicians and pundits jeered, predicting defeat.

Hearings were held, but there was no progress until President Nixon, who also supported the Commission's recommendations, appointed Winton "Red" Blount to be PMG. Blount took the job on condition that Nixon would back him up on postal reform. Nixon agreed, but commented, according to Blount, that it would take at least eight years. In a remarkable display of tenacity and persuasiveness, Blount got it done in less than a year. The Postal Reorganization Act of August 12, 1970 was born.

That Act, however, departed in two major ways from Kappel's report and Blount's bill. It created the Postal Rate Commission, an unprecedented arrangement in which five presidential appointees set prices, de facto, for an organization run by nine other presidential appointees. It also established a binding arbitration process for postal workers' wages.

With the passage of time, the negative consequences of the Postal Service's limited management authority became alarming, and on September 24, 1976, Congress established a study commission. Witnesses' testimony, my own included, had little effect. With members representing conflicting interests, failure was guaranteed. Its April 1977 report, pickled with dissents, sank without a ripple, as do most commission reports. The problems, however, remained, and in 1995, the House Subcommittee on the Postal Service, chaired by Representative John McHugh, began hearings.

On November 15, 1995, I testified before that body as well. I described both the unbusinesslike constraints placed upon the Postal Service and management blunders that could not be blamed on the statute. Notwithstanding my strong preference for the normal legislative process, I recommended that a better, well-designed and issue-focused bipartisan commission identify the root causes undermining the Postal Service. I tried to explain why some commissions were helpful and others not, and suggested at least ten issues that needed analysis.

Some observers sensed that the McHugh subcommittee might ignore Congress' unachievable demands for businesslike operations. Accordingly, on May 20, 1996, I co-authored an Op-Ed piece on the Washington Post setting forth the rationale for a new commission. Seven months later, on June 25, 1996, McHugh introduced H.R. 3717, the postal reform bill, which did not address the key issues as we saw them. There were more hearings. Lawyers, lobbyists and consultants made a ton of money.

David Ginsburg, a former member of the Kappel Commission and a friend, arranged meetings with Erskine Bowles, President Clinton's Deputy Chief of Staff; Elaine Kamarck, who ran Vice President Gore's "Reinventing Government" campaign; as well as OMB and Council of Economic Advisors staff. There was interest but no support. In May, 2002, I met with Jay Lefkowitz, head of the White House domestic policy office. In July, his staffer, Kristine Simmons, arranged a meeting with Treasury Undersecretary Peter Fisher. Fisher said, in effect, something must be done, this is serious business. The enormity of the Postal Service's economic impact and the fact that GAO had placed the Postal Service on its High Risk List clearly caught his attention.

At the same time, mailers who scoffed at the commission initiative could no longer blink at the evidence that the Postal Service could be headed for deep trouble. There was no flood of support, but one at a time, mailers, unions, postmasters, and even competitors asked the President to establish a new postal commission. And so he did, but short-changed it on time (six months) and staff (five people and a few bucks for consultants).

The Commission met its deadline. As noted earlier, it avoided the PRC-Board of Governors layering issue and the arbitration issue, but offered over thirty recommendations. Its July 2003 report was ignored for months. Finally, the White House produced a Statement of Principles whose relationship to the Commission's report was tenuous, at best. Its principal "Principle" was a demand that any bill must be "budget neutral." OMB and Treasury spokesmen said that any bill inconsistent with that Principle would be vetoed. Congress and the White House ultimately compromised on this and other issues, and the bill became law.

Who are the winners and losers? Make your own list; here's mine:

<u>Winners</u>: Newspapers and competitors such as United Parcel Service and FedEx. In the short run, unions, which have all their rights and benefits preserved. (The American Postal Workers Union opposed the bill because it regards the rate cap as a wage cap, and is hostile to work-sharing and negotiated service agreements.) Thousands of nonprofit mailers, such as AARP, universities, religious congregations, the American Civil Liberties Union, and the National Rifle Association will continue to enjoy subsidies at other mailers' expense.

<u>Losers</u>: All mailers are at risk, depending on the degree to which they use the mails. Magazines, weekly newspapers, advertising mailers, banks, credit card companies, and nonprofit fundraisers depend on the mails. If it weakens or crashes, they have no economic alternative. Greeting card publishers are similarly vulnerable. In the long run, unions may be losers. The level of wages and benefits may drive volumes down, creating powerful pressure for outsourcing.

Iraq, illegal immigration, staggering budget and trade deficits, and a broken health care system are national high priorities with which the nation continues to struggle. Still, better attention must be paid to an industry affecting every American, including nine million workers, directly or indirectly.

Eric Sevareid's mordant remark comes to mind: "The chief cause of problems is solutions."