



TESTIMONY OF

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To the

Special Panel on Postal Reform and Oversight

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Mr. Chairman, Representative Davis, Members of the Committee:

My name is Gary Mulloy. I am Chairman and CEO of ADVO, Inc., the largest in-home print advertising company in the United States. We touch eight out of ten American households weekly or monthly and are the Postal Service's largest user of standard mail. I am pleased to represent the 3,700 ADVO associates that service over 20,000 of the nation's small and large businesses. They and the shareholders of our NYSE-listed company are counting on the wisdom and leadership of this body and so are the employees, customers and owners of all the businesses we serve who rely upon the services of the United States Postal Service to strengthen their individual businesses and the U.S. economy. I am also pleased to speak on behalf of saturation mailers more generally. Collectively we mail 15.2 billion advertising pieces and packages through the Postal Service each year. The Postal Service would not be viable without this volume and the revenue it generates.

ADVO is proud to have worked with many of you on this committee, particularly Representatives McHugh of New York and Davis of Illinois, as you have struggled to implement positive change that would modernize the Postal Service while protecting this national asset entrusted with the important policy objective of universal service to ensure that the citizens of our country have access to this important communications network.

I have submitted extensive written testimony for the record, intended to help as you consider legislation to ensure that the Postal Service will be able to effectively compete in the market and efficiently meet the nation's needs well into this new century. My written submissions cover a range of issues from the price-setting mechanisms and process to cost management measures the Postal Service should take. Once needed reforms are made, I am optimistic that the Postal Service can continue to serve the citizens and businesses of our nation and can play an important role in fostering future economic growth for our country. My brief remarks today, however, are intended to call your attention to a few of the key issues detailed in those documents.

For at least the past 15 years, postal rates have been higher than truly necessary to fund the operations of the Postal Service. The result has been non-competitive pricing which has led existing and potential customers elsewhere. It has also led to the creation of competitive alternatives that have drained revenue and profits from the Postal Service. Some, like us, have even begun private delivery alternatives as a necessary hedge against rising postal costs which in some cases are nearly twice that of a private delivery system.

We believe that all of us in private industry would use the USPS more, and both the Postal Service and industry would experience significant growth if prices and rates were established and maintained in a more market-oriented, efficiently run system.

ADVO estimates that a hypothetically restructured USPS could offer prices that would enable us to seek to triple our business to a \$3 billion dollar organization. Other saturation mailers could see similar growth opportunities. Our current strategy calls for us to double our business over the next few years, but much of that growth will, of necessity, be outside the Postal Service unless changes are made. Our growth will come from both the largest companies in our country as well as from the very smallest businesses. Small businesses in particular look to the mail to provide otherwise unaffordable advertising that reaches their lifeblood — the local customer.

The shame is that mail *can* be delivered at a price that would give these small businesses the vehicle they need to compete. The potential market is big enough to pay for universal service for a long time to come. It is big enough to end discussion about five-day delivery and get the Postal Service thinking about the opportunities presented by seven-day mail delivery instead. It is even big enough to relieve pressure on some of the traditional features of the Postal Service that the American public has long enjoyed, such as Post Offices in some of the smallest communities in our country.

To tap into this potential market, the Postal Service must be able to offer competitive prices. A necessary step is to continue the current period of rate stability beyond the

2006 date that has been promised as a result of legislation supported by the members of this committee on the CSRS issue. The volume generated by this hiatus in rate increases, coupled with the impact of the adoption of the important reforms under consideration by this committee, would set the Postal Service on a positive course for the next generation. A major element of this positive course would be for the Postal Service to keep rates at current levels at least through 2008, and we believe such a period of rate stability is not only desirable but also reasonable and achievable.

Stable rates are not a pipe dream. This committee can lead the Congress to make them a reality. Since 1971 the Postal Service has been required, as you know, to break even by charging mailers its cost of operation. Contrary to general perceptions and media misrepresentations, the USPS has not been chronically losing money or breaking even in its operations. In fact, since it was created, the Postal Service has generated an operating profit, and a handsome one at that.

That's right.

Since 1971, postal revenues have been billions of dollars more than the cost to fund the operations of the USPS. Even if Congress were to force the Postal Service to book 100 percent of its health care liability for retirees today, the Postal Service still would have generated billions more in excess revenue through rates charged mailers in the past and still in place today.

Where has that money gone? To the Federal Treasury.

That's right. The USPS is not only NOT subsidized by the taxpayer; instead, surprisingly, it has been subsidizing the taxpayer.

Last year this committee took the first steps to correct the retirement overpayments made by the USPS to the U.S. Treasury. This important first step was only a partial, temporary solution and included some provisions that are not in the long term best interests of the Postal Service, its customers, or the economy.

Part of last year's legislative "fix" of CSRS required the Postal Service to pay military, Peace Corps and other government retiree benefits. This action transferred \$28 billion in additional obligations to ratepayers. These costs are not rightly the responsibility of the Postal Service and its consumers and customers. Unlike other federal agencies, the USPS does not receive federal appropriations but must charge its consumers and customers for the services it provides. The cost of military service time for most federal agencies is paid for by the general treasury, and thus taxpayers as a whole. Singling out postal ratepayers to cover this obligation that benefits all taxpayers is thus unfair. Customers are able to cover the costs of Postal Service operations through the rates we pay. However, adding additional expenses, such as retirement benefits earned as the result of military service, pushes postal rates up to uncompetitive levels, drives business to seek alternatives, and undermines the financial viability of the Postal Service itself. The Presidential Commission's recommendation to undo last year's damage by removing responsibility

for military pensions from Postal Service customers should be immediately acted upon by this body. The USPS and its customers have no more business paying military retirement benefits than paying for missiles, or traffic lights or public housing. Of course all of the customers of the Postal Service (with the exception of nonprofit mailers) are also taxpayers, and our taxes fund these and other programs. To be required to pay for them again through higher postage rates is a form of double-taxation.

In implementing last year's fix to the CSRS over-funding, the OPM made an accounting change with regard to allocating the responsibility to pay for pensions earned as a result of work performed by postal employees prior to 1971. The 1970 Postal Reorganization Act made the Treasury responsible for employee benefits earned while working for the old Post Office Department and it made the Postal Service responsible for benefits earned after it took over. For years, the benefit obligation for retirees with employment both before and after 1971 was allocated between the Postal Service and the Treasury based on the number of years of service employed at each agency, allocating the same dollar amount to each year of employee service. Last year, when the factual actuarial error regarding CSRS funding was corrected, the Office of Personnel Management quietly switched to a new allocation method that effectively shifted a large portion of the pre-1971 obligation to the Postal Service to the detriment of Postal Service and therefore its consumers and customers. While there can be legitimate disagreement about the proper method for making judgements about allocating the benefit obligation, the factual actuarial error is not open to judgment and opinion. The allocation method used for 32 years was fair and was recently determined to be consistent with common practice by an

actuarial firm commissioned by the Postal Service. Changing it now shifts pre-1971 Treasury obligations to the Postal Service and its ratepayers as a sort of penalty for finally correcting factual actuarial errors that had been allowed to stand for years. The difference between the old allocation method, which had been in place for years, and the new method, imposed by OPM, changes the Postal Service's balance sheet by tens of billions of dollars – far more than enough to fully fund both CSRS and retiree health benefits liabilities. This is an unfair burden that today's Postal Service and its consumers and customers should not have to bear.

Additionally, the legislation passed last year required that, for 2006 and beyond, the Postal Service must resume making overpayments to the CSRS system (in the form of escrow payments) until Congress is satisfied with the Postal Service's plans. Because these funds are from Postal Service consumers and customers — us — they should be used to their — meaning our — benefit. Those benefits include operational efficiencies and productivity improvements while rate stability and volume growth are maintained. In other words, those benefits would provide an overall stimulus for the U.S. economy.

This Committee can take steps toward righting these wrongs and put the Postal Service back on track to growth with better, expanding service. Congress can and should take strong action to clean up the misallocation of billions of dollars in paid-in retirement dollars by the USPS by:

First, returning the allocation methodology for retirement benefits earned by USPS workers before 1971 to the method utilized prior to last year. The USPS has appealed to the Board of Actuaries, as provided for in last year's legislation, but there is no need for Congress to await the result of that appeal to apply this common sense solution and eliminate the effects of this arbitrary punitive action.

Second, by transferring responsibility for military and other government service benefits back to the general Treasury to recognize that the Postal Service is unlike other federal agencies that receive federal appropriations.

Once relieved of both of these unfair burdens the Postal Service will be able to fully fund its CSRS and retiree health benefits liability.

Finally, the Congress should repeal the escrow provision of last year's law (Public Act 108-18) through at least 2008 and allow the true profitability of the operations of the Postal Service to be utilized to invest in productivity and efficiency improvements and generate the economic stimulus of rate stability for this critical component of the U.S. economy.

According to some of the most respected economists studying the postal industry, if all of these retirement issues are addressed in a comprehensive way, with the help of other meaningful reforms to control costs and grow the business, the Postal Service will be able

to fund its retiree health care obligation, eliminate debt, and freeze rates for years beyond the requirement of the current law — at least through 2008 and possibly beyond.

With the retirement funding issues addressed, the principles for postal reform articulated by the administration will succeed. In particular, I would note the urgency of applying the principles of best practices and flexibility to the areas of pricing and costs. The Postal Service needs to be able to respond to the marketplace and, as the Presidential Commission recommends, be given greater ability to enter into contracts with its customers, large and small. The Postal Service must also be given the tools to control costs and manage its resources. These steps will allow the Postal Service to build substantial volume that covers its costs and contributes properly to overhead at a time that the Service will be undergoing major systematic changes that you are championing. I would again call your attention to the written materials I have submitted to the Committee which goes into greater detail on these and other issues.

The stakes for our economy and the business users of the USPS could not be higher. Without prudent action by this Committee and Congress, there is no question that the USPS will eventually crumble under the weight of non-market pricing that subsidizes general treasury functions. The fate of our employees, our customers, the employees of our customers, and our collective shareholders hang in the balance of your deliberations.

Thank you for your attention today and for the time and energies you have already spent on our behalf.