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11:30 AM March 13 meeting
PostMaster and President
Briefing Paper

February 4, 1975

MEMORANDUM FOR THE PRESIDENT

THRU: JIM CAVANAUGH
FROM: GEOFF SHEPARD
SUBJECT: United States Postal Service

BACKGROUND

As you are aware, the Nixon Administration sponsored the Postal Reorganization Act of 1970 which removed the Post Office from the Executive Branch and created the new United States Postal Service. The Postmaster General is now solely responsible to a Board of Governors nominated by the President and confirmed by the Senate. The intent of the legislation was to remove the Postal Service, with its \$12.5 billion budget and 700,000 employees, from the realm of politics and patronage and make it a cost effective operation. Personnel costs now account for about 85% of this budget.

The Postal Service suffered a deficit of \$438 million in FY 1974. Part of this was anticipated because a six month delay between the settlement of new labor contract and the start of increased rates in January 1974. Another \$124 million of this resulted from automatic cost-of-living mechanisms in postal worker contracts and the inflated cost of fuel. The Postal Service projects a \$960 million deficit for FY 75 if current factors remain constant.

To make up the FY 74 loss, the Postal Service borrowed \$500 million. To repay this and to cover anticipated debts and deficits in FY 75, the Postal Service is going to request a rate increase of 2¢ to 3¢ in first class and a corresponding increase in other classes of mail. The rate increase will be formally presented to the Postal Rate Commission in March and will likely cause a uproar from the public and the Congress. Although it may lead to renewed threats by the Congress to reincorporate the Postal Service into the Cabinet, passage of legislation increasing existent Federal "Public Service" subsidies is more likely. A bill recently introduced by Congressman James Hanley, Chairman of the Postal Service Subcommittee, would raise government subsidies from nearly 10% to 20% of the Postal Service's Budget. It would also reserve two thirds of the appointments to the Board of Governors to the Congress.



The Postal Service faces other difficulties this year, which may further disrupt its financial stability:

In the Summer contract negotiations will begin. Postal worker union's have won large salary and benefit packages in recent years that have raised them above other government workers. Union leaders are threatening strikes if negotiations prove unsatisfactory. While a national strike is unlikely, local wildcat actions or slowdowns are probable. Postal workers are asking for substantial pay increases and benefits.

The Postal Service has engaged in an extensive process of revising mail handling procedures and relocating facilities. The former has led to intermittent dislocation of service and resulted in public outcry. The latter has often brought about local and political pressure to prevent relocation. The Postal Service has invested nearly \$2 billion in capital projects during the first three years of its operation to revise antiquated facilities and machines that had been neglected during the last years of the Post Office. Several GAO reports within the last year have criticized the Postal Service's purchase of experimental machinery, alleging mismanagement.

The operation of the Postal Rate Commission has been detrimental to the effectiveness of the Postal Service. Its two main functions are to review rate increases and suggest changes in mail classification system. The 10¢ first class stamp is still a temporary rate being examined by the Postal Rate Commission. The Postal Rate Commission has also been ineffective in reviewing mail classification to assure equitable rates for the different classifications of mail. OMB is currently reviewing the operations of the Postal Rate Commission and may recommend changes in the Postal Reorganization Act to strengthen it.

The Postal Service currently faces both tremendous public and employee relations problems:

The former largely stems from the rapid growth of the cost of postal service from a time when rates were deliberately kept down by government subsidies. The 1970 Act places most of the burden of costs on the individual mail user, although phased subsidies have temporarily reduced the burden on third class mail users e.g., publishers. Public dissatisfaction with increased costs is also enhanced by real or perceived diminution of service resulting from cost-cutting or mail handling alterations in postal operations.

Conflict with employees began soon after the inception of the Postal Service. E.T. Klassen, who became Postmaster General in late 1971, brought in a management team from private industry which clashed with the



bureaucratized mailworkers. Mechanization and conscious efforts to decrease the size of the work force worsened relations. Substantial pay and benefit increases strengthened union leadership and resistance to management. In the last year, Klassen attempted to bridge the gap between management and labor by institutionalizing grievance meetings and in-house training and promotion of supervisors, but the animosity remains.

Klassen, a target of numerous allegations of malfeasance and mismanagement by Jack Anderson, resigned last month. He has been requesting a meeting with you since last Fall to brief you on problems facing the Postal Service, but your schedule has not permitted it. A schedule proposal for this meeting has been resubmitted to include Klassen and his successor, Ben Ballar, who will take office on February 15, 1975. He was hand picked by Klassen and was appointed by the Postal Board of Governors unanimously. He, like Klassen, was a former American Can Executive and has been with the Postal Service for two years. He has the personal respect of the Board of Governors and of many Congressmen, but his association with Klassen may cause Congressional criticism.

OUTLOOK

The Postal Service faces a difficult period in the near future. The postal unions will try for expensive contract settlements. They will watch closely the Federal employees struggle against the 5% ceiling. Powerful interest groups like the publishing industry will attempt to pass on third class mail increases to the taxpayer in the form of phasing subsidies. Elements of the Congress will support the efforts of these forces with legislation supporting their goals. The rate increase should balance the deficits facing the Postal Service, barring a new inflationary wave or a revenue loss from a strike.



THE WHITE HOUSE

WASHINGTON

March 12, 1975

MEETING WITH THE
POSTMASTER GENERAL, BENJAMIN F. BAILAR

Thursday, March 13, 1975

11:30 a.m. (30 minutes)

The Oval Office

From: Jim Cannon

I. PURPOSE

To discuss the problems of the U.S. Postal Service, specifically labor contracts, debts and proposed rate increases.

II. BACKGROUND, PARTICIPANTS AND PRESS PLAN

A. Background:

The cost of postal operations has been increasing rapidly. The Postal Service is planning to increase rates again by 25% to 30% this July. Congressional pressure is building for increasing and extending Federal subsidies to hold down costs to mailers. The resolve of Postal management to maintain the goals of the Reorganization Act is important if the principle of users paying for the service they receive is to be successful.

The key to controlling postal costs is in holding down wages which amount to 80% of costs. Postal workers have a superior wage-benefits package, but the unions are demanding an even more expensive contract with the threat of a strike. The PMG's stand in upcoming contract negotiations will have a significant impact on the Postal Service's ability to control costs as well as the Administration's efforts to maintain a 5% Federal pay raise ceiling. The PMG has already stated he is not in favor of the ceiling.

PMG Bailar will be looking for Administration support, particularly during the period of the upcoming labor contract negotiations. The PMG is concerned that Administration spokesmen not make public statements that a postal strike would be completely unacceptable or other comments that would undermine the Postal Service's negotiating position. In the event of a strike by the unions, the PMG will be asking for your consideration of the use of the National Guard.

B. Participants:

Benjamin F. Bailar
Myron A. Wright
Jim Cannon
Jim Lynn
Albert Rees
Bill Usery

C. Press Plan:

None

III. TALKING POINTS

1. I firmly support the Postal Reorganization Act of 1970. I believe that the Postal Service should manage the mail service without outside political interference. Postal management should be given every opportunity to make postal reorganization work.
2. I believe that the users of the mails should pay for the Service. I do not favor additional subsidies which transfer costs from postal users to the taxpayer. Postal costs, therefore, should be covered by increased rates rather than subsidization.
3. I am aware of widespread complaints about the ineffectiveness of the Postal Rate Commission. There have been problems of continuity and level of leadership there. I intend to improve the quality matter of appointments to the Postal Board of Governors and the Postal Rate Commission.
4. A matter of mutual concern is the Postal Service's upcoming contract negotiations with the Postal unions. As you know, I am opposed to large inflationary wage increases and have recommended a ceiling on Federal wage hikes this year. I hope that the Postal Service will work to obtain a reasonable settlement that will not endanger efforts to combat recession and inflation.
5. There has been talk of a general postal strike or selected walkouts if the unions do not obtain their demands. This could present major problems. We all should be considering how the Government might prepare for and respond to a major strike. I would like the Labor Department and the Federal Mediation and Conciliation Service to work with you in examining the problem. We do not want to inflame the issue by massive Federal preparation's at this time.
6. I agree we need to maintain a closer working relationship and I will ask Jim Cannon to be responsible for assuring effective communications.



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U.S. Postal Service

Background Briefing Paper

Following the recommendations of the Kappel Commission, developed in the late sixties, the U.S. Postal Service was established as a quasi-independent government corporation by the Postal Reorganization Act of 1970. Under the reorganization, traditional executive and legislative control, such as that exercised over the former Post Office Department, was greatly limited. The new postal corporation was given a free hand in directing all facets of postal operations and charged with the responsibility to provide prompt, reliable and efficient postal service nationwide on a self-supporting basis.

One of the first tasks of the new corporation was to deal with obsolete and inefficient practices of the former Post Office Department. The new management has been successful in its efforts in a number of areas: while mail volume is up six percent, the work force has been trimmed by some 40,000 employees; the system has been depoliticized; executive development, training and promotional opportunities have been broadened; and physical working conditions have been improved. The new management subscribes to the belief that our postal service is "the best in the world."



Despite these successes, however, and efforts to mechanize various aspects of mail processing, the quick turnaround in postal services many envisioned in 1970 has yet to materialize. Many of the old problems continue to persist. Productivity gains have been difficult to achieve in a basically labor intensive operation.

The most pressing problems are financial. Since reorganization, the new service has been running fairly sizable yearly deficits:

(\$ in millions)	1971 <u>Actual</u>	1972 <u>Actual</u>	1973 <u>Actual</u>	1974 <u>Actual</u>	1975 <u>Est.</u>	1976 <u>Est.</u>
Total Operating Budget	9,042	9,641	9,853	11,095	12,554	13,496
Federal subsidy-included above	(N/A)	(1,417)	(1,410)	(1,698)	(1,546)	(1,490)
End of year deficit	-200	-175	-12	-438	-864	-1,673

The present economic situation has further exacerbated postal financial problems by driving up costs. The projected 1974 deficit of \$438M is due almost entirely to inflationary pressures resulting from the settlement of a liberal labor contract, cost of living adjustments, increased fuel costs, and higher international air transportation rates. The projected deficits of \$864M and \$1,673M for 1975 and 1976 assume no reduction in service, change in rates, or increase in costs. Upcoming labor negotiations will, however, inevitably add to operating costs, further increasing the projected deficit and laying the groundwork for a future rate increase. Every one-cent increase in fuel costs the Postal Service another \$3.5M.



In order to grasp the complexities of postal financing problems, one needs to look at a number of interrelated factors such as service levels, labor and non-labor costs, rates, borrowing authorities, and the Federal subsidies. Over the next year we face a number of policy questions in these areas which will have a definite impact on how successful postal reorganization will be.

Service Levels

Complaints about poor service have persisted, particularly from the large commercial mailers. Some efforts to revise handling procedures and relocate facilities have led to disruptions and periodic public outcries. Efforts to economize in 1972 by laying off 50,000 employees resulted in a serious delay in moving mail over the Christmas holidays and resultant public indignation.

Postal Service has been investing heavily in mechanization and capital improvement projects. A \$1 billion dollar effort has gone into developing a bulk mail network in an attempt to recapture business which has been rapidly eroding away to its competitor, United Parcel Service. As with all experimental efforts, there have been delays and disappointments. Many GAO reports have criticized postal management's handling of contracts and the general R&D efforts. The postal unions have also been strong in their opposition to further mechanization. In an effort to economize in recent months cuts have been made in many proposed capital expenditures.



There is little opportunity in the near term to cut costs in the service area. Already, Postal Service has cut back on collections, limited deliveries to once a day and eliminated Saturday business deliveries. Thought has been given to eliminating Saturday residential deliveries, with a potential one-time savings of \$250M, but such a move would be politically sensitive and no serious consideration is being given at this time.

Wage Costs

The predominant factor in increasing postal costs is wages. With over 700,000 employees, postal wages account for 85 percent of all postal costs. Under the Reorganization Act, the Postal Service is to maintain compensation for its employees which is comparable to that paid in the private sector. Initial wage negotiation with the unions, covering some 500,000 employees, have proven, however, to be quite liberal; providing postal employees with a more favorable wage and benefit package than Federal employees and better than many major industry packages. New negotiations with the unions are scheduled to begin this spring on the present contract which expires July 20, 1975. Indications are that the unions will be seeking wage increases of 10% or more, cost of living adjustments, fully paid health, dental, and retirement benefits, a 35-hour work week, and continuation of the no layoff agreement.



The postal unions are extremely powerful and militant and have threatened strike action unless their demands are met. In the 93rd Congress, right to strike legislation was one of the hottest employee bills, which was subject to a number of hearings. Although it is conjectural whether or not a national strike would occur, local walkouts such as those which occurred in New York during the 1969 negotiations may repeat.

The new Postmaster General, Benjamin Bailar, has already indicated that he does not favor the Administration's proposed 5 percent ceiling on Federal wages. However, unless postal management takes a strong position in the upcoming labor negotiations, then rate increases will continue to follow in order to cover costs and pressure for additional Federal taxpayer-supported subsidies will build. With the present work force a 5.5 percent increase in labor contract costs would increase postal costs by close to half a billion dollars a year.

Rates

If the principle of users paying for the services they receive succeeds, then eventually revenues from rates must cover postal operations. In order to hold levels of service, the Postal Service has turned on a recurring basis to increases in postage rates to cover operations and to finance its deficits. Thus, far, postal rate increases have come with such regularity that serious questions about the public acceptance of a break-even operation, where first class stamps could climb to 20 cents or more, have begun to be asked.



Postal rates are subject to review by an independent Postal Rate Commission. The purpose of this Commission is to review postal rates, classes, and services and to make recommendations thereon to the Board of Governors of the U.S. Postal Service. The Commission, under the Reorganization Act, is also required to review and make recommendations concerning a reclassification of the various classes of mail service. Almost since its inception in July 1971, the Commission has been under fire; accused of lacking either purpose or direction. Strong critics of the Commission believe it is a repository for political hacks and has-beens, and many claim its operation has been detrimental to the effectiveness of the Postal Service.

The Rate Commission has become, in effect, a rubber stamp for Postal Service rate proposals and has done little to really assess the strengths and weaknesses of postal management decisions.

Current rates are still temporary rates, awaiting final recommendations from the Rate Commission. That decision is expected in the next few months. In the meantime Postal Service is preparing a new rate proposal for submission to the Commission as soon as the current rates are made permanent. It is expected that Postal Service will seek a 25 to 30 percent hike with first class going to 13¢. This would go into effect sometime this summer on a temporary basis.



Borrowing Authority

Under the Reorganization Act, Postal Service may borrow money, issue notes, etc. primarily for capital improvement purposes, as long as the aggregate amount of outstanding debt does not exceed \$10 billion. There are however, limitations: in any one fiscal year the net increase in obligations cannot exceed \$1.5B and there is a \$500M limitation on net increases in borrowing to defray operating expenses.

Postal Service has already borrowed \$500M in a public offering to help finance its FY '74 operating deficit. This short term borrowing is to be covered by \$1 billion in long term notes which are being financed through the Federal Financing Bank in FY '75. Borrowing of this type may help short term operating problems but in the long run higher rates for subsidies will be necessary to cover these debts.

Federal Subsidies

One of the major underlying principles of postal reorganization was to establish a break-even operation, where eventually users would pay for the services they received. To assist in the transition from the old departmental status, Federal subsidies of approximately \$1.5 billion a year have gone to the Postal Service to help maintain service to all communities and to allow for the phased adjustment of various rates up to full cost recovery levels. These subsidies are (in theory) eventually to be phased out.



Subsidies are provided for three purposes:

1. To cover old liabilities attributable to Post Office Department employees (approximately \$60M/yr.).
2. To cover public service cost of maintaining postal operations in communities that may not otherwise be deemed self-sustaining (\$920M/yr. through 1979; then declining by 10 percent each year until 1984)
3. To cover the revenue foregone by the Postal Service in carrying certain classes of mail (second, third and fourth class) at free and reduced rates (approximately \$500M/yr., declining over a ten-year period).

Because of public resistance to increased postage rates the prospect of further rate hikes have begun to build pressure in Congress to increase and expand the various subsidies to the Postal Service as a way to stave off these future increases. Legislation already introduced this session by Congressman James M. Hanley (D-NY) would add another \$1 billion a year in taxpayer support by doubling the public service subsidy in an effort to cover increasing costs and hold down the need for increasing rates in the future.

The proposed rate hike this summer is however inevitable and will probably lend strong support to efforts among some vocal members of Congress to reappraise the postal reorganization concept and at a minimum insure action on increased Federal funding for the Postal Service with the possibility of some increased controls over postal management. Subsidies to cover revenue foregone on carrying certain



classes of mail at reduced rates have been and continues to be the most controversial issue. Under the Reorganization Act, Federal subsidies were authorized to ease the adjustment for business and non-profit mailers in moving from a historically low subsidized rate to one which is more reflective of the actual cost of the mail service provided. This was done recognizing that mailers could not sustain the rate increases that would be required to recover full costs. A 5-year adjustment period for profit mail and 10 years for non-profit mail was provided as a transition period during which rate increases were to be phased-in equal annual increments.

During the last session of Congress, legislation (S. 411) sponsored by Senator McGee (D-Wyo) was enacted extending this phasing period by three years for profit mail and six years for non-profit mail. To fund this legislation would cost the taxpayers approximately \$750M over the next 13 years. The President has decided (on two different occasions) not to seek appropriations for this additional subsidy.

Special interest mailers (both profit and non-profit) have been relentless in their efforts to secure further subsidies for second and fourth class mail, citing higher than anticipated increases in rates and the "general public" value of their mailings, particularly magazines. Allegations that increasing rates are putting firms out of business have, however, not been substantiated. Postal cost typically only represents five percent of a publisher's overall expenses. This pressure is expected to continue.



Since reorganization, the President has not requested funds for phasing third class mail ("junk" mail or advertising mail). The Congress has gone along with this recommendation each year and not appropriated these funds. As a result, rates for this class of mail have gone to full cost recovery levels.

Summary

The dilemma facing the executive (and legislative) branch is that it is increasingly under fire from various sectors to do something about deteriorating postal services and increasing rates - while it is effectively isolated from being able to influence either. In the long run, postal reorganization might prove to be a success, but the short run problems must be addressed and resolved if that is to be so. Postal operations have a big impact on the Federal budget and a broad spectrum of commerce.

Since reorganization there has been little in the way of a review of postal cost allocations, levels of efficiency, and service, and quality of management decisions. Such information is important if we are to address the evolving policy issues.

In the next few months we will need to address such questions as:

1. Should we continue to support the break-even principle in the Act? Is the Postal Service a business or a service?
2. Where do we stand on the broad question of public service subsidies vs. higher rates?
3. Should mailers be given additional time to adjust to higher rates?



4. What steps if any can be taken to control postal costs?
e.g., labor costs.
5. What steps should be taken to improve the functioning of the ratemaking process? Should the Administration support amendments to the Act regarding the Postal Rate Commission?

