

Committee on Oversight and Government Reform  
Subcommittee on the Federal Workforce, Postal Service, and the District of Columbia

Written Testimony of James O'Brien  
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Mr. Chairman and Members of the Subcommittee, my name is Jim O'Brien. I am Vice President of Distribution and Postal Affairs for Time Inc. The largest magazine publisher in the United States, Time Inc. publishes 22 magazines in this country. Each month, one out of every two American adults reads a magazine from my company.

I am here today for Time Inc. and the Magazine Publishers of America, the industry association for consumer magazines. The MPA represents approximately 225 U.S. publishing companies with more than 1,000 titles.

About 90 percent of printed magazines in this country are delivered to their readers via the Postal Service. So Time Inc. and the MPA care greatly about the Postal Service, its financial situation, its future viability, and its effectiveness in controlling the costs of the Periodicals class that we use to deliver our magazines.

We have been long-time partners with the Postal Service in examining postal and mailer operations to improve efficiency, streamline mail processing, and reduce costs. In 1998, I participated in a joint USPS/Periodicals mailers task force. We visited seventeen postal facilities at all hours of the day and night to see every step in the processing of Periodicals mail. I continue to visit postal facilities regularly to observe operations and examine areas for improvement. My most recent visit was only three weeks ago.

These examinations have produced results. Following our 1998 joint task force, the Postal Service issued a Strategic Improvement Guide for Flats Processing. A main focus of the guide was to reduce the manual processing of Periodicals mails. To do our part, Time Inc. and other MPA members have made many changes to our magazines and preparation processes over the years to make our mail easier and less expensive for the Postal Service to handle. Despite our best efforts, however, the Postal Service's reported cost of Periodicals mail has continued to rise. This trend deeply concerns the publishing industry. I appreciate the opportunity to give my perspective on these issues here.

**The Value of Magazines to the Postal Service and the Public**

Magazines are extremely valuable to the Postal Service and the public, as the Postal Service and Congress have long recognized. More than one Postmaster General has called magazines "the anchor in the mailbox"—i.e., mail that consumers really look forward to receiving and that draws them to their mailboxes every day. This value has

been confirmed by the Postal Service's Household Diary Study, which shows magazines right behind packages as the type of mail households like the most.

Congress has repeatedly recognized the value of magazines to educate, elucidate, and inform the citizens of this nation. Periodicals have received special consideration under postal laws since the founding of the nation. This longstanding tradition was continued in both the Postal Reorganization Act of 1970 and the Postal Accountability and Enhancement Act of 2006, which require consideration of "the educational, cultural, scientific, and informational (ECSI) value to the recipient of mail matter" in setting postal rates. Magazines possess ECSI value in abundance.

The importance of Periodicals to the Postal Service extends beyond the hard copy magazines we mail. The Postal Service profits greatly from Periodicals publishers' use of other classes of mail—especially First-Class Mail and Standard Mail. To generate subscriptions and provide customer service, Periodical publishers send large volumes of subscription promotions, gift subscription offers, acknowledgments of subscriptions, invoices, renewal notices, reminder notices, ancillary and cross-product promotions, and other correspondence with customers. Most of this mail is sent via automated letter-shaped First-Class Mail and Standard Mail.

Although our volume of promotions mail has decreased during the recession, when I analyzed Time Inc.'s postage in First-Class Mail and Standard Mail several years ago, the results were quite significant. For every dollar we spent on Periodicals postage, we spent 75 cents on First-Class and Standard Mail on magazine-related mailings. These are the categories of mail with the biggest profit margins for the Postal Service.

### **Publishers Have Worked Hard to Reduce Processing Costs for Periodicals**

The magazine industry has been and remains deeply concerned that the attributable costs of Periodicals, as measured by the Commission, have increased more than inflation over the last 25 years. This trend is especially disturbing to us because MPA and its members have devoted a great deal of time and resources during the past two decades in an ongoing effort to identify and implement ways to minimize the work required for the Postal Service to process and deliver our magazines. From FY 2004 to FY 2009 alone:

- The percentage of Periodicals pieces sorted to the most-efficient and least-cost Carrier Route level increased from 47 to 55 percent;
- The percentage of Periodicals pounds privately shipped and entered at a destination facility rose from 57 to 65 percent; and
- The number of sacks – more expensive for the Postal Service to handle than pallets – declined by 65.9 percent. In FY 2000, Periodicals mailers used approximately 110 million sacks. Today, we use 28 million sacks.

I brought with me today a bundle of copies of Time Magazine prepared to maximize efficiency for the Postal Service. All the pieces in this bundle are destined for the same

carrier route. We truck bundles like this from our printing plants to hand off the magazines to the USPS at facilities near our subscribers. The bundles remain intact throughout the process, and no one has to open them or handle individual pieces until the bundles are opened by the letter carriers who make final delivery of the magazines. Other than taking the bundles to the destination ZIP Code and handing them to the letter carrier ourselves, this is the most efficient product that we can give to the Postal Service – and we and other publishers are making up more bundles like this all the time.

This improvement in preparation – while very beneficial to the Postal Service – is costly to publishers. We must pay printers, consolidators and truck companies for co-mailing, co-palletization and trucking. We have incurred these extra costs in order to stem the increases in Periodicals costs. And it worked. Periodicals costs were relatively flat between 1999 and 2003. However, despite our significant investments to improve efficiency and reduce costs for the Postal Service, Periodicals costs – as measured by the Commission – have once again begun to outpace inflation.

### **Excess Capacity Has Prevented Potential Cost Savings from Being Realized**

The Postal Service’s extensive investment in equipment to automate flat-shaped mail should have led to significant reductions in mail processing costs for flats, including Periodicals. Similarly, mailer efforts to make Periodicals cheaper and easier for the Postal Service to handle should have reduced the Postal Service’s costs.

But that hasn’t happened. Why?

We have learned from many years of analyzing postal operations and costs that a key problem facing the Postal Service – and a major reason for the continuing increase in Periodicals costs – is excess capacity. This excess capacity has been created by the failure of the Postal Service to reduce its workforce when its workload has declined.

There are multiple reasons for workload declines for the Postal Service, including:

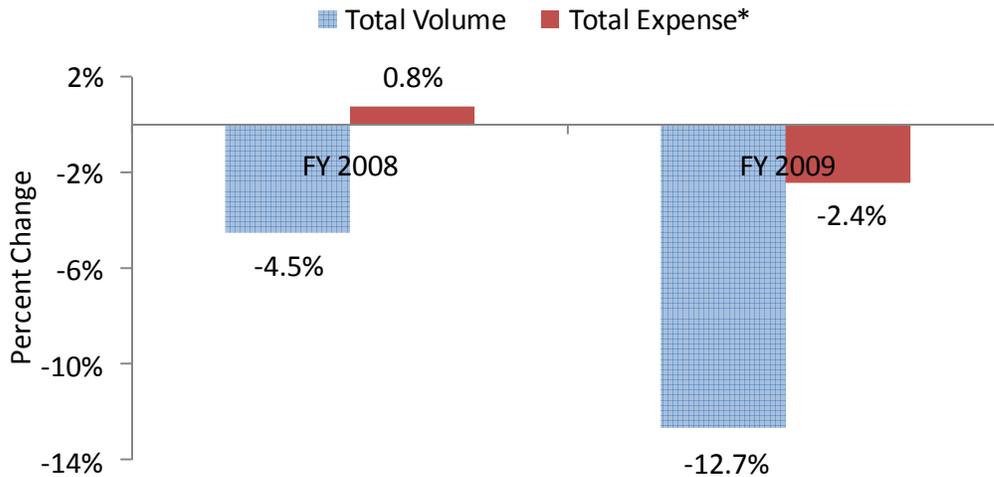
- increasing automation of the mail processing function, which has reduced the number of processing clerks needed for a given processing operation;
- changes in mail preparation that eliminate some of the processing and transportation that the Postal Service used to do;
- and in recent years, shrinking mail volumes.

The Postal Service’s workforce, however, has not shrunk as fast as the Postal Service’s workload. This is not a new problem. In fact, the increases in Periodicals costs can be tracked back to 1986, when the Postal Service started its letter mail automation program. Time Inc. even coined a phrase to explain what happened to Periodicals as a result of letter mail automation. The term is “automation refugees,” and over the years more and more people have come to understand what that concept means. It means that excess capacity in one processing operation can make another processing operation less efficient. Machines are idled while manual processing occurs in order to absorb the

available labor capacity, and classes that had nothing to do with the automation see their costs go up.

The excess capacity problem that we noticed early for Periodicals has worsened and broadened in the past few years with significant declines in mail volume.

The chart below shows the magnitude of the problem in the last few years. Adjusting for differences in amounts paid into the Health Benefit Fund in 2007-2009, the chart shows that in 2008 total mail volumes declined 4.5 percent but expenses actually increased. Similarly, in 2009, total mail volumes declined almost 13 percent but costs decreased by only 2.4 percent.



\*For consistency, FY 2009 costs adjusted to reflect full \$5.4 billion RHB fund payment and FY 2007 costs adjusted to exclude transfer of escrow to RHB fund.

In my experience, excess capacity often leads to manual processing despite the availability of automation. And manual processing leads to increased costs. In the Strategic Improvement Guide issued by the Postal Service after our 1998 joint task force, the Postal Service quantified the problem, circa 1997: “In FY97, we failed to automate over 6 billion barcoded flats – and had we processed them through automation, we would have saved over \$54 million.”

When I have visited postal facilities over the past 13 years, I have often observed flat sorting machines standing idle while Postal Service personnel sorted Periodicals manually rather than running them on the machines. This doesn’t happen in the case of letter mail, because the Postal Service removed manual letter cases from its facilities. But manual processing areas for Periodicals remain.

In a postal facility in the New York area, just three weeks ago, I saw an operation that the Postal Service informally refers to as a “bullpen.” A sign at the top of the bullpen said “Hot Publications Staging Area.” Inside the bullpen, were hampers for mail handlers to manually sort bundles of Periodicals. Why do manual processing areas continue to exist

in so many processing facilities? Facility personnel, when asked about manual processing, sometimes claim it is done for “service reasons.” But I have never asked for manual processing, and I don’t think other publishers have either. In fact, the reverse is true. Our industry has literally begged postal personnel for years to put Periodicals on flat sorting equipment. We have made every change the Postal Service has asked for – including turning our mailing labels upside down – to ensure that Periodicals could be automated.

We believe that extensive manual processing survives because the Postal Service has not succeeded in reducing its workforce enough to match reduced processing needs. The costs of this excess capacity should not be charged to Periodicals and other similarly-situated classes – either directly because of unnecessary manual handling or indirectly because of increased overhead costs.

### **Periodicals Costs Are Overstated**

The Postal Service’s existing cost systems overstate the costs attributed to Periodicals. First, they assume that all costs are incurred efficiently, and that all worker time and other resources spent on processing a particular class of mail are needed by, and of benefit to, that mail. Charging periodicals for the extra costs of manual processing that periodical publishers did not request and do not need, is unjust and unreasonable. And it is inconsistent with the policy of the law that postal rates should reflect the costs of honest, economical and efficient operations.

Second, existing methods also overstate attributable costs by making unrealistic assumptions about the extent to which costs vary with changes in mail volume. For mail carrier costs, there is a general consensus that some of the costs are fixed (or institutional in postal parlance) in the short or medium run. For mail processing costs, however, the Postal Regulatory Commission has assumed for many years that virtually all costs are variable, and therefore should be attributed to individual mail classes. This assumption has led to protracted debate. For a decade in six different rate cases, the Postal Service tried to convince the Postal Rate Commission that mail processing costs were not fully variable and thus should not be fully attributed to classes. Several respected PhD economists demonstrated on behalf of the Postal Service that mail processing costs did not increase or decrease fully with volume, but had volume variability only in the range of 70-85 percent. Periodicals costs would look quite different if the Commission agreed that mail processing costs are not fully volume variable.

### **In FY 2009, Periodicals Likely Covered Short-Run Attributable Costs**

In June 2009, the Postal Regulatory Commission approved the Postal Service’s “summer sale” discounts for Standard Mail. In seeking the discounts, the Postal Service argued that the relevant measure of attributable costs for evaluating whether the discounted rates would cover costs was *short-run* attributable costs—the costs that varied with volume in the short-run during a period in which there was excess capacity—rather than long-run attributable costs, i.e., costs which assume a time period over which all excess capacity

has been shed. The Postal Service estimated that, because of excess capacity, the short-run attributable costs of the two Standard Mail categories with cost characteristics most similar to Periodicals were only 66% and 51% of their long-run attributable costs.

The same logic applies to the pricing of Periodicals mail. Although short-run attributable costs were not estimated for Periodicals Mail (because Periodicals Mail wasn't part of the "summer sale" case), Periodicals' short-run attributable costs probably were a similar percentage of their long-run attributable costs during the summer sale period. As shown in the chart above, the Postal Service's limited cost savings in 2009 suggest that excess capacity was present throughout the year. It is likely, therefore, that Periodicals Mail fully covered its short-run attributable costs—the proper measure of attributable costs during periods of excess capacity—in 2009 and made a positive contribution to Postal Service finances.

### **The Postal Service and Postal Regulatory Commission Continue to Examine These Issues**

As I mentioned, in 1998, I participated in a joint USPS/Periodicals mailers task force to look at some of the issues I've addressed today. Twelve years later, many of the problems we identified are still unaddressed, and many of the questions we asked are still unresolved. The Postal Service and the Postal Regulatory Commission are currently looking at many of the same issues again. Their report is due within the next few months. Hopefully, this study will provide additional insights and recommendations.

The stakes are high for publishers and the Postal Service. Time Inc. and the other magazine publishers in the MPA plan to continue publishing our magazines for a long time to come. But we can achieve that only if postal rates for Periodicals remain affordable. An above-inflation increase while advertising is just beginning to recover from the recession could have devastating consequences. To answer the question posed in this hearing's title: Yes, the Price *is* Right. Periodicals and other non-letter shaped mail should not be asked to shoulder the burden of costs they did not cause. We stand ready to work with this Committee and Congress, the Administration, the Postal Service, and the Postal Regulatory Commission to find the right path forward for the Postal Service. Thank you for the opportunity to speak to you today.