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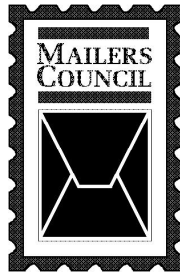
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MAILERS COUNCIL

POSTAL SERVICE PRODUCTIVITY: REAL IMPROVEMENTS NEEDED NOW

MARCH 8, 2000

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1. EXECUTIVE SUMMARY

The Mailers Council, a coalition of mailers and mailing associations that collectively represents as much as 70% of the nation's mail volume, believes a robust postal system is vital to the success of its member organizations and American businesses. The Council believes that the Postal Service can be operated more efficiently and supports efforts aimed at containing postal costs.

The Council recognizes that there are factors that threaten the Postal Service's future success because they have influenced a decline in productivity and revenue. These factors include increasing competition (both from existing and new technologies), operating and cost management constraints (some imposed by outside entities), and especially the consequences of management decisions. As a result of these factors, at a time when every competing technology is becoming less expensive, the cost of using the nation's mail system is becoming more expensive.

To ensure the Postal Service's survival, therefore, the Mailers Council believes postal management must focus its considerable skills and resources on those factors it can control, and thereby generate needed productivity gains. Recognizing the difficulty of this challenge, we present this report as a means of renewing our dialogue with senior postal managers on the issue of productivity.

Although the Postal Service is unlike any other government agency or private sector organization, we believe comparing postal operations to similar industries can help determine whether the Postal Service has been reasonably successful in improving its productivity. Since the 1991 recession, the Postal Service's Total Factor Productivity (TFP) compares unfavorably with all business productivity measures generated by the Bureau of Labor Statistics.

The issue of labor costs best illustrates the need for renewed attention to productivity within the Postal Service. Labor costs represent nearly 80% of the Postal Service's operating costs. Labor costs continue to escalate both because of a larger workforce and because of higher salaries. The Postal Service's automation program has helped limit increases to the postal workforce, but labor costs continue to increase. Precisely because the Postal Service does not have the same labor negotiation process as comparable industries in the private sector, there is a greater need to reduce labor costs by increasing labor productivity.

The Postal Service can also improve productivity by controlling logistics costs, an accomplishment that will more than benefit mailers. Because the Postal Service provides a large and increasing proportion of parcel and expedited shipments, lower USPS logistics costs would significantly lower the nation's logistics costs. Reduced logistics costs would also benefit America's emerging e-commerce economy—the Postal Service's most promising source of new business because of the rapidly increasing parcel delivery business it generates.

The Mailers Council believes that the Postal Service's already stated commitment to improving productivity must include an aggressive, public implementation timetable of programs the Postal Service should identify as helping achieve its productivity goals—including new management incentives to achieve the long-term objectives described in this study. The Council is prepared to offer our opinions on the pilot programs the Postal Service is considering, and our members offer their assistance in implementing those approved for funding.

2. THE NEED FOR IMPROVING POSTAL SERVICE PRODUCTIVITY IS INCREASING

The Mailers Council is a coalition of over 50 corporations, nonprofit organizations and major mailing associations. Council members represent for-profit and nonprofit mailers that use the United States Postal Service to deliver correspondence, publications, parcels, greeting cards and payments. Collectively the Council accounts for as much as 70% of the nation's mail volume. The Mailers Council believes that the USPS can be operated more efficiently, supports efforts aimed at containing postal costs, and has the ultimate objective of lower postal rates without compromising service.

The Mailers Council believes a robust postal system is vital to the success of its member organizations and of American businesses in general. There are factors, however, that threaten the Postal Service's future success because they have influenced a decline in productivity and revenue. They include increasing competition (both from existing and new technologies), operating and cost management constraints (some imposed by outside entities), and the consequences of management decisions. As a result of these factors, at a time when every competing technology is becoming less expensive, the cost of using the nation's mail system is becoming more expensive.

The Postal Service today faces unprecedented competition, as detailed later in this report. Several foreign postal administrations have joined US corporations in competing for letter and parcel delivery through traditional technologies. And new technologies, notably those enabling e-commerce, threaten to dramatically reduce some of the Postal Service's most profitable letter mail volume.

Some of the Postal Service's expenses are beyond its control. Here are three examples:

- Labor costs represent nearly 80% of the USPS' operating costs. The Postal Service can do a better job of controlling the size and scheduling of its workforce to compensate for wage increases set by an independent arbitrator. For example, in November 1999 an arbitrator awarded a substantial pay increase to city letter carriers that could add \$300 million annually to postal labor costs.
- The Postal Service is particularly sensitive to certain expense items, such as fuel, for which there are no alternatives. The Postal Service operates a fleet of 192,000 vehicles and spends over \$4 billion on contracted transportation services (all of which are affected by higher fuel costs passed on to the Postal Service). The USPS also follows a mandate to provide universal service six days a week to over 130 million delivery points. A one-cent increase in the price of fuel increases the Postal Service's costs by over \$1 million. After a long period of price decreases, fuel costs have risen over 40% since January 1999.

- When the nation was dealing with severe budget deficits in the early 1990s, Congress frequently passed legislation that required the USPS to pay billions of dollars in unanticipated costs. That legislation contributed to a negative equity figure that at one time exceeded \$9 billion.

The Postal Service cannot control some of its biggest cost factors or its competition; therefore, to ensure the Postal Service's survival postal management must focus its considerable skills and resources on those factors it can control, and thereby generate needed productivity gains. Council members represent postal customers using the full spectrum of Postal Service products, and so would benefit from better control of postal costs through improved Postal Service productivity.

Recognizing the difficulty of that challenge, the Mailers Council presents this report as a means of renewing our dialogue with senior postal managers on the issue of productivity. This report's findings are intended to highlight a problem that we believe requires immediate attention, and we offer our support in finding ways of improving postal operations, and thus improving productivity.

Productivity improvement has been a concern among mailers for some time because the Postal Service's productivity growth record since Congress implemented the Postal Reorganization Act on July 1, 1971, is inconsistent. Between 1972 and 1998, the Postal Service experienced only a 9.1% growth in total factor productivity (TFP), most of which occurred prior to the 1991 recession.¹² The Postal Service experienced high productivity growth only in the years 1973, 1978, 1990 and 1993, and an overall negative productivity growth for all other years combined.³

The high productivity in 1973, 1978 and 1998 can be linked to the close relationship between improving labor productivity (LP) and TFP. Exhibit 1 compares the two measures for the years 1993 through 1999.

In each of the years during this period, the Postal Service's labor productivity was higher than TFP, the difference averaging slightly over 1%. The difference identified in the chart indicates that to improve TFP the Postal Service must improve labor productivity at an even higher rate than has been historically the case.

¹ TFP measures the changes in the relationship between Postal Service outputs (products) and the labor, capital and other inputs or resources expended while producing those outputs.

² Including the partial year FY 1999 productivity of -1.3% would lower cumulative TFP to 7.7% since reorganization.

³ US Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century. Statement of Bernard L. Ungar, General Accounting Office in Testimony before the Subcommittee on the Postal Service Committee on Government Reform, US House of Representatives, October 21, 1999, p. 18.

| Exhibit 1 Comparison of Postal Service Total Factor and Labor Productivity (1993 - 1999) | | | | | |
|---|-------------------------------|------------|------------------------------|------------|--|
| Year | Postal Service TFP Growth (%) | | Postal Service LP Growth (%) | | |
| | Annual | Cumulative | Annual | Cumulative | |
| 1993 | 3.8 | 3.8 | 4.4 | 4.4 | |
| 1994 | -0.1 | 3.7 | 0.7 | 5.0 | |
| 1995 | -1.8 | 1.9 | -1.3 | 3.7 | |
| 1996 | -1.2 | 0.7 | -0.2 | 3.5 | |
| 1997 | 1.2 | 1.9 | 1.6 | 5.1 | |
| 1998 | -1.1 | 0.9 | 1.2 | 6.3 | |
| 1999 | -0.3 | 0.6 | 0.7 | 7.0 | |

Notes:

1) Postal Service TFP between 1988 and 1998 is from the 1998 Comprehensive Statement of Postal Operations, p. 73.

2) 1999 productivity estimates were provided to the Mailers Council by the Postal Service.

The year with the largest increase in productivity, 1993, was also the year that total USPS career employees declined by over 33,567 or 4.6% of the prior year number.⁴ Each of the years with negative TFP in this period are years in which the number of postal career employees grew by more than 1%. In addition to 1993, the other years in the USPS' history with high TFP growth, 1973, 1978 and 1990, experienced reductions in USPS career employees of 21,812, 2,441 and 17,047, respectively.⁵

The period in the chart (Exhibit 1) reflects the timeframe of letter automation implementation. Throughout this period the proportion of letters with barcodes increased, the number of sortation steps handled with automated equipment increased, and mechanical letter sorting machines were eliminated. The productivity trend in this period raises the concern that while management was focused on improving letter-sorting productivity, managers failed to pay sufficient attention to the productivity of other Postal Service processes and non-letter-shaped mail.

⁴ Annual Report of the Postmaster General, Fiscal Year 1994.

⁵ Annual Report of the Postmaster General, Fiscal Year 1991, Annual Report of the Postmaster General, Fiscal Year 1978, and Annual Report of the Postmaster General, Fiscal Year 1973.

In its current Performance Plan, the Postal Service forecasts an ambitious 3.1% increase in TFP and a 3.1% increase in labor productivity.⁶ The Postal Service has achieved this type of goal in only 4 of the past 28 years.⁷ In addition, given the recent link between labor productivity identified above, the growth in TFP projected would require a growth in labor productivity greater than what is planned.

⁶ Fiscal Year 2000 Annual Performance Plan, United States Postal Service, p. 23.

⁷ This productivity level was achieved in the years 1973, 1978, 1990 and 1993.

3. POSTAL SERVICE OVERALL PRODUCTIVITY HAS BEEN BELOW PRIVATE INDUSTRY PRODUCTIVITY

Determining how effective the Postal Service has improved its productivity is problematic. Year-to-year comparisons are one indicator, but those figures fail to show whether the Postal Service has implemented some of the same innovations as similar organizations in the private sector. But determining which private sector organizations are comparable is an inexact proposition because the USPS is a unique institution: an independent establishment of the executive branch of the federal government. Although operated in many ways like a private sector organization, the Postal Service has requirements unlike those set for any comparable private sector company, and faces a continuously changing set of cost demands, many imposed by individuals who do not work for the Postal Service.

While we acknowledge that the Postal Service is unlike any other government agency or private sector company, we believe, nonetheless, that comparing postal operations to those industries most similar can help determine whether the Postal Service has been reasonably successful in improving its productivity.

Since the 1991 recession, the Postal Service's TFP compares unfavorably with all business productivity measures generated by the Bureau of Labor Statistics (BLS). The BLS measures the overall, or multi-factor productivity (MFP) of three subsets of the US economy, private businesses, private non-farm businesses and manufacturers.⁸ Exhibit 2 shows the cumulative productivity between 1991 and 1999.

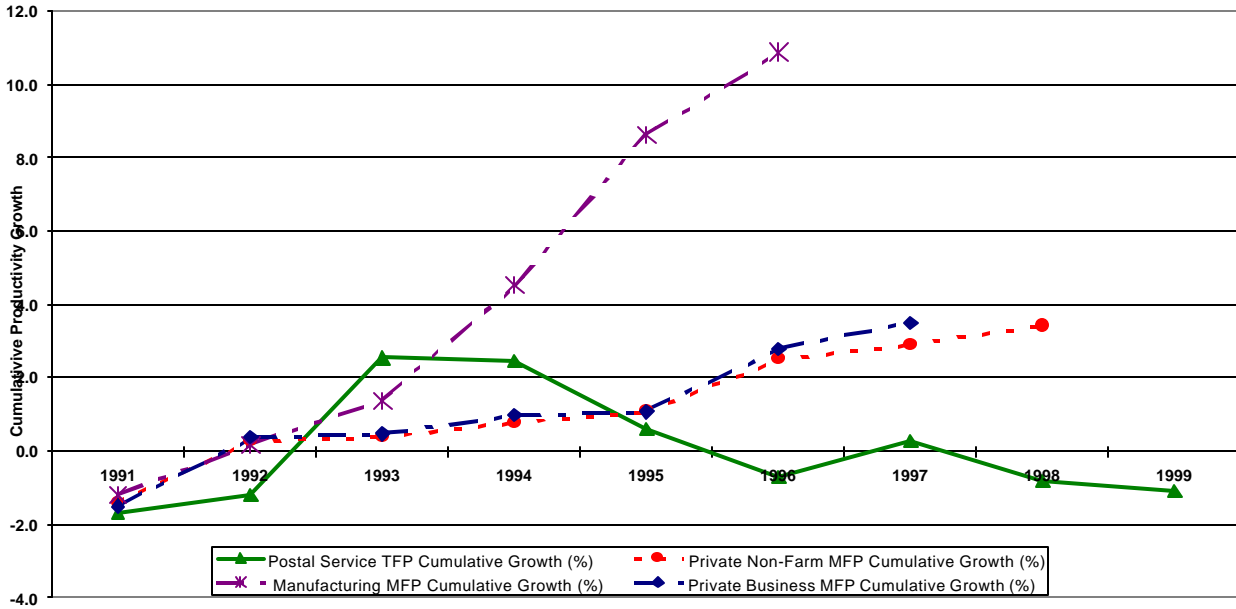
For the years since 1991 in which the BLS has generated multi-factor productivity measures, all of its private sector productivity measures have shown significant gains, while the Postal Service has generated negligible change in productivity.⁹ In the most recent years, USPS productivity has turned downward and the gap between private sector productivity has most likely widened.

In comparing itself to the private sector, the Postal Service has traditionally used the index with the lowest productivity gain, the private non-farm MFP. With the expanded use of automation and mechanization, comparisons with manufacturing productivity are increasingly relevant because postal processes are becoming increasingly similar to those found in modern automated manufacturing and logistics environments. As Exhibit 2 shows, the Postal Service is falling fastest behind the productivity gains of manufacturers.

⁸ "The multifactor productivity indexes for major sectors measure the value-added output per combined unit of labor and capital input in private business and private nonfarm business. Multifactor productivity indexes for aggregate manufacturing and for 20 manufacturing industries provide measures of sector output per combined unit of capital (K), labor (L), energy (E), materials (M), and purchased business services (S) inputs—KLEMS inputs." Chapter 10: Productivity Measures: Business Sector and Major Subsectors, BLS Handbook of Methods, BLS Bulletin 2490, April 1997, pp. 89-102, http://www.bls.gov/opub/hom/homch10_a.htm.

⁹ Multifactor Productivity Trends, Bureau of Labor Statistics, Tables 1, 2, and 3. Bureau of Labor Statistics, <http://www.BLS.gov/news.release/prod3.toc.htm>

Exhibit 2
Comparison of Postal and Private Sector Productivity (1991-1999)

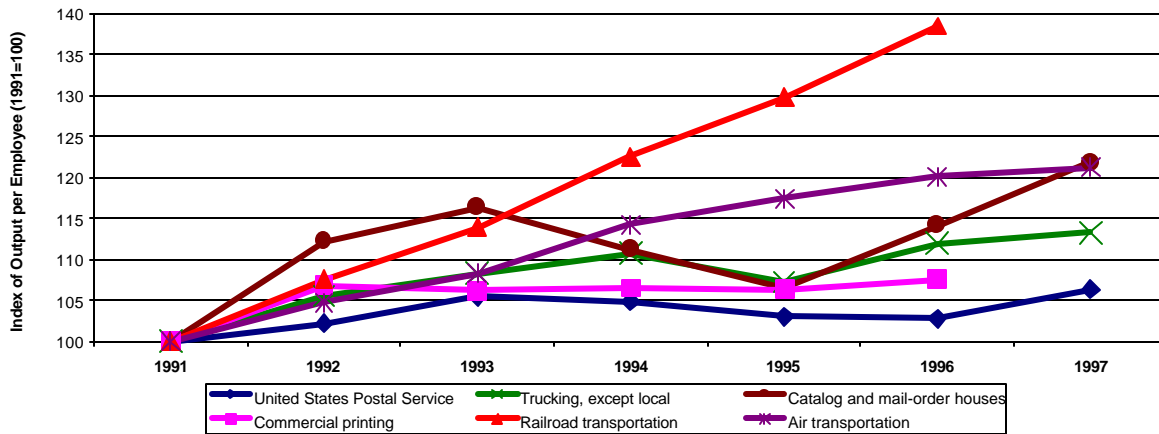


Source: Multifactor Productivity Trends, Bureau of Labor Statistics, Tables 1, 2 and 3. Bureau of Labor Statistics, <http://www.bLS.gov/news.release/prod3.toc.htm>, the cumulative productivity for the period.

In addition to having unfavorable overall productivity growth, BLS data indicates that since the 1991 recession, the Postal Service's labor productivity improvement has been below that of suppliers, competitors and customers. These industries include transportation companies, commercial printers, and catalog and mail order houses (see Exhibit 3).

Between 1991 and 1997, the Postal Service experienced slightly more than 6% growth in productivity per employee. The trucking industry experienced a growth more than twice as large. Airline and catalog and mail order industries experienced three times the growth in productivity per employee. Data for railroads and commercial printers are available only through 1996. In this period, commercial printers experienced over 2.5 times the productivity per employee as the Postal Service, and railroads experienced nearly 14 times the Postal Service's improvement rate.

Exhibit 3
 Bureau of Labor Statistics Index of
 Output per Employee for Selected Industries
 (1991-1997)



Source: Indexes of Output per Employee, All Published Industries, Industry Labor Productivity Data Tables, Bureau of Labor Statistics, <ftp://ftp.bls.gov/pub/special.requests/opt/dipts/oeaiin.txt>

Because of its unique constraints, the Postal Service may be unable to achieve the dramatic productivity improvements experienced by some of the industries cited here. We believe, however, that the recent experiences of some of these industries present a learning opportunity for the Postal Service. This is especially true with those organizations that must cope with increasing competition generated by advances in technology or regulatory reform.

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4. POSTAL PRODUCTIVITY AFFECTS ALL CUSTOMERS

Productivity improvement programs must focus on all areas of postal operations to aid all postal customers. This section discusses how specific postal products would be affected by productivity improvement programs targeting the USPS' three largest operating areas:

- window service and mail processing,
- city carrier delivery, and
- transportation.

WINDOW SERVICE AND MAIL PROCESSING

Improving the productivity of window service and mail processing operations conducted by clerks and mail handlers would have the greatest effect on all postal customers. A recent analysis indicates that between 60 and 70% of all of the costs associated with a broad range of postal products studied are related to mail processing and window service.¹⁰ The one exception was Standard A Enhanced Carrier Route (saturation advertising mailings), for which one-third of all costs come from window service and mail processing.¹¹

CITY CARRIER DELIVERY

Improving the productivity of city carrier delivery would have the greatest effect on enhanced carrier route mailing costs, the product where the Postal Service provides little more than the final delivery. Nearly two-thirds of the costs studied for this product were related to city carrier delivery.¹² Improving city-carrier delivery productivity would also have a significant effect on all nonparcel postal products. City carrier delivery represented between 19 and 36% of the costs of First-Class, Periodicals and Standard A products studied.¹³ City carrier delivery productivity has a small effect on parcel products because the costs associated with city carrier deliver represent only 7% of the total cost studied for Parcel Post and Library Rate.¹⁴ Improving the productivity of other delivery modes should also help control the costs of those products most affected by city carrier delivery costs.

¹⁰ *Data Quality Study, Technical Report #3—Simulation Analysis of Data Quality Issues*, LINX, a division of A.T. Kearney, Inc., April 16, 1999, p. 44. Most other costs are attributed and distributed to products, using the analysis of cost segments analyzed in the study. Therefore, the percentages reported here provide an approximation of the magnitude of the impact that improving productivity in one area would have on the costs of particular products.

¹¹ Ibid.

¹² Ibid., p. 45.

¹³ Ibid.

¹⁴ Ibid.

TRANSPORTATION

Improving the productivity of contracted and postal transportation resources would have the greatest effect on the costs of the periodical and parcel products. Twenty-eight percent of parcel post costs studied were associated with the two highway and one air transportation cost segments studied in the Data Quality Study. Transportation costs studied represented 16% and 11% of the costs of Library Rates and Periodicals—Regular Rate respectively.¹⁵

¹⁵ Ibid., p. 46.

5. WEAK POSTAL SERVICE PRODUCTIVITY HAS THE GREATEST EFFECT ON CONSUMERS AND SMALL BUSINESSES

The Mailers Council represents large and small mailers, both for-profit and nonprofit. Our research indicates that consumers and small business postal customers are most affected when the USPS' productivity fails to improve; however, even large mailers would benefit from placing more attention on operational productivity.

In recent years, the Postal Service's most effective method for increasing the productivity of distributing mail has been increasing the opportunities for worksharing and drop shipping. Mailers could reduce their costs of distributing mail by using private sector providers of mail preparation, sortation and transportation. This process has been described by the Postal Service as "Quiet Liberalization," and has a value of \$11.7 billion in postal costs saved.¹⁶ The actual savings depends on the price mailers paid to private sector companies to replace Postal Service efforts. The difference between the productivity of the Postal Service and private sector providers is demonstrated by the speed that mailers choose to replace Postal Service efforts with their own or those of private sector suppliers.

One drawback of quiet liberalization is that it does not benefit all Postal Service customers equally. Those customers with the opportunity to use private sector mail suppliers gain the benefit of competition in purchasing these services. A Postal Service customer's opportunities for using the private sector depend on both the volume of the mail in an individual mailing and the proportion of delivery addresses to be served in specific geographic areas. Single piece and low volume mailings have limited physical delivery options. As such, consumer and small business mailing costs are held in check only when the Postal Service makes a concerted effort to improve productivity from collection to delivery.¹⁷

Today, however, even larger mailers recognize the weakness of "quiet liberalization." All mailers have portions of the postal network that they cannot avoid. Based on their experience using private mail preparation, distribution and transportation firms, they know the difference between the price the Postal Service and the private sector charge for these services. These larger firms also know that if the Postal Service targeted its operating productivity to better compete with the private sector, mailing costs would decline for all customers.

¹⁶ "Hiding In Plain Sight: The Quiet Liberalization of the United States Postal System" presented by Mary S. Elcano, R. Andrew German and John T. Pickett, at the Seventh Conference on Postal and Delivery Economics, Current Directions in Postal Reform, June 23-26, 1999, Snta, Portugal.

¹⁷ Single-piece and low volume physical delivery options include air express or courier shipment, fax and electronic transmission to a destination printer. For some documents, fax and electronic transmission are not options, as these hard copy delivery modes cannot now provide the same visual impact that a customer printed document could have.

For individual mailers and small businesses, the gain would be even greater because their use of the postal network is greater. Increasing postal mail preparation, sortation and transportation productivity in a process designed to compete effectively with private sector providers of these services would reduce costs of the entire collection-to-delivery mail service on which individuals and small businesses heavily depend.

6. IMPROVING PRODUCTIVITY REQUIRES A FOCUS ON LABOR COSTS

The issue of labor costs best illustrates the need for renewed attention to productivity within the Postal Service. Today, labor costs represent nearly 80% of the Postal Service's operating costs. Labor costs continue to escalate both because of a larger workforce and because of higher salaries. The Postal Service's automation program has helped limit increases to the postal workforce, but labor costs continue to increase, not only in response to inflation but often as a result of third-party arbitration decisions. Precisely because the Postal Service does not have the same degree of control over its labor costs as its private sector competitors, there is a greater need to reduce labor costs by increasing labor productivity.

Reducing postal employment may not be the easiest step for postal managers to take; however, three trends suggest that reduction is critical. First, pension costs are becoming an increasing portion of total expenses. In 1991, pension costs represented 10.2% of operating expenses. In 1998 they represented 13.3% and have grown at 2.5 times the rate of all other costs. Pension costs are a fixed expense that will have to be recovered—regardless of what happens to mail volume. Therefore, reducing labor costs now is essential to reducing long-term expenses. Furthermore, unless the Postal Service reduces its labor costs beyond these sizeable fixed liabilities, postage increases to cover them in the future will be inevitable and substantial.

Second, changes in the mix of mail reduce the amount of work associated with each mail piece, and therefore reduce measures of postal output.¹⁸ Changes in mail characteristics that are likely to reduce the measurement of postal productivity include increases in drop-shipping, increases in presorting, preparation and palletization, and decreases in the volume of First-Class single-piece mail. All of these activities reduce the price paid to the Postal Service and the value of output in productivity measurement. The shift in mail mix also increases the amount of material handling and changes the mix of employees required to handle mail. For example, since 1991, the number of postal clerks has grown by 4.6%, while the number of mail handlers has grown by 22.6%.¹⁹

Third, increases in the price of labor, fuel and borrowed money will all elevate pressure on the Postal Service. In 1999 the Postal Service signed new agreements with most of its unionized employees, including a binding arbitration settlement with city letter carriers that will increase their pay grade beginning in November 2000. The resulting cost increase only magnifies the importance of programs designed to improve letter carrier efficiency. Fuel

¹⁸ Postal output would be greatest for single-piece mail where all processing to delivery are required. Presorting, mail preparation and drop shipping all increase the "quality" of mail and, therefore, reduce the output measured per piece. The "cost" of the higher quality mail is the difference in postal revenue between single piece and workshare mail. A comparable example would be a manufacturer that makes one product using completely unassembled parts and a second product using assembled subassemblies. The labor output associated with the second product would be lower in this example.

¹⁹ Postal Service Annual Reports.

prices, which have risen over 40% since January 1999, directly translate into transportation cost increases through fuel adjustment clauses. Interest rates also have risen over the past year, and additional increases would not be unexpected. Rising interest rates will increase postal retirement costs because interest represents approximately one-fifth of pension costs.

Understanding how these three trends will put pressure on postal costs, the Postal Service recognized the critical need to improve labor productivity by setting a goal in FY 2000 of 3.1%.²⁰ However, as noted earlier, this ambitious objective may not be sufficient to meet the Postal Service's TFP goal.

The Postal Service said it would achieve its productivity with a reduction in labor hours of 1%.²¹ The small reduction in workhours is expected to produce the larger percentage in labor productivity. This reduction is equivalent to reducing the number of career employees by more than 7,000. Additional labor productivity improvements will come from anticipated mail volume growth.

The Postal Service goals would be much larger if the USPS attempted to catch up with the labor productivity of the comparative industries identified. For example, matching the labor productivity of the trucking industry since 1991 would require reducing full-time employment by 48,000. Reducing employment in line with the productivity gains of the catalog and mail order house industry would require a reduction of 100,000 employees. Although these numbers seem large, improving labor productivity would at worst require the Postal Service to return to its 1993 employment levels.

Even though its FY 2000 labor reduction goals are modest, the Postal Service has no track record of meeting such goals. A GAO analysis indicates that from 1994 to 1997 the Postal Service has not met its goal of reducing city and rural carrier hours. The total delivery workhours reduction was 15% below that forecast because of factors such as changes in labor agreements and increases in the number of delivery points.²²

A key factor influencing the Postal Service's difficulty in meeting delivery workhour goals has been declining city carriers street efficiency, for which productivity improvement programs have been in the design stage since 1995.²³ We believe some of these pilot programs hold great promise and could be effective tools needed to achieve the type of dramatic labor productivity goals the Postal Service has set.

²⁰ *Fiscal Year 2000 Annual Performance Plan*, United States Postal Service, p. 23.

²¹ *U.S. Postal Service: Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century*, Statement of Bernard L. Ungar, General Accounting Office in Testimony before the Subcommittee on the Postal Service Committee on Government Reform, House of Representatives, October 21, 1999, p. 7.

²² *United States Postal Service: Progress Made in Implementing Automated Letter Sequencing, But Some Issues Remain* (GAO/GGD-98-73, April 17, 1998).

²³ *Ibid.*

7. IMPROVED POSTAL SERVICE PRODUCTIVITY IS REQUIRED FOR IMPROVED LOGISTICS PRODUCTIVITY

Logistics costs include all costs associated with maintaining and distributing goods and services, including inventory carrying costs, transportation costs and administrative costs. In 1980, prior to railroad and trucking deregulation, logistics costs in the United States represented 16.5% of GDP. Today, logistics costs represent 10.6% of GDP. This change comes from two sources: 1) a reduction in inventory carrying costs, in particular the interest cost of holding inventory; and, 2) a reduction in transportation costs. The transportation portion of logistics costs has declined at a somewhat slower rate, from 7.7% of GDP to 6.2% of GDP.²⁴

Although the long-term trend is positive, recent trends are less encouraging. Since 1991, logistics costs, as a percent of GDP, have remained nearly unchanged, particularly if the effect of lower inflation is included.²⁵ More importantly, transportation costs as a proportion of GDP have grown from 6.0 of GDP to 6.2%. In the 1980s rationalizing of the nation's long-haul rail and truck transportation networks made significant gains in transportation productivity. The opportunities for further gains are much more limited in this area. Furthermore, the overall level of transportation costs is affected by the long-term shift to more costly ground and air small parcel services offered by the Postal Service and its competitors, including United Parcel Service and FedEx.

In 1980, small shipments represented 3.5% of the nation's transportation budget. In 1997, their proportion of the transportation budget increased to 6.9%.²⁶ The development of retail e-commerce is expected to increase the shift of transportation costs toward ground and air parcel carriers. Given the increasing importance of small shipment transportation costs to the nation's logistics budget, improving the productivity of this transportation sector is required if logistics, and in particular transportation costs, are to regain the downward trend of the past decade.

Improving Postal Service productivity by controlling logistics costs will more than benefit mailers. Because the Postal Service provides a large and increasing proportion of parcel and expedited shipments, lower USPS logistics would significantly lower the nation's logistics costs. A recent study indicates that the Postal Service handles 44.7% of the domestic air

²⁴ 10th Annual "State of Logistics Report": A Look Back In Anger at Logistics Productivity, Robert Delaney, delivered at the National Press Club, June 7, 1999.

²⁵ Ibid., Figure 17.

²⁶ This figure includes the revenue generated in the handling of small shipments by the Postal Service, United Parcel Service, scheduled air carriers, and specialized air cargo carriers, railroads and bus companies. Airline revenue associated with the handling of mail is subtracted from the small shipments revenue figure. Source: Transportation in America, CRA report of the Postal Service and Revenue, Pieces and Weight reports. Postal Service parcel revenue for all years may be underestimated based on changes presented in the 1998 Revenue, Pieces and Weight report.

shipments through its Express Mail and Priority Mail products.²⁷ Its market share in ground parcels is small but significant for household delivery, particularly for delivery of smaller items. Revenue generated from all of the Postal Service's air and ground small shipment products has nearly doubled since 1991. These products include Priority Mail, Express Mail, Parcel Post, and Standard B Special Subclass. Postal Service small shipment products now represent 0.8% of the nation's transportation bill, as opposed to 0.5% in 1991. The Postal Service's share of the small shipments market grew by 55% in this six-year period.

Given the Postal Service's increasingly important position in the small shipment markets, reducing the nation's logistics costs will decrease only if the Postal Service significantly improves its operating efficiency.

²⁷ "Postal Service in US Air Market in 1998, Colography Group Report Says," Press release, August 10, 1998.

8. AN EFFICIENT UNITED STATES POSTAL SERVICE IS NEEDED FOR THE INTERNET ECONOMY

The Internet economy is doing more than replacing physical distribution of some hard-copy communication with electronic messages. The Internet economy is expanding the need for services offered by the Postal Service and its competitors. In particular, the expansion of the Internet has introduced new products that require advertising and increased the demand for distribution of parcels. An efficient Postal Service will benefit postal customers and reduce the marketing and logistics costs of America's emerging e-commerce economy.

Advertising created for new Internet and e-commerce products and services employs the same media, including mail, to draw customers as does traditional commerce. In promoting e-commerce, mail is a particularly valuable tool for selling products and services that focus on targeted audiences in business (such as realtors, doctors or lawyers) where mass media are not cost effective. The Postal Service delivers advertising primarily through two mail classes, Periodicals and Standard A. The Postal Service experienced rapid growth in the use of these products for delivery to businesses and other nonhouseholds between 1992 and 1997. The growth in Periodicals and Standard A mail to businesses and other nonhouseholds has been 94% and 100% respectively.²⁸ This represents an annual growth rate of 14.1% for Periodicals and 14.9% for Standard A mail. The rapid growth in business to business advertising and periodicals is remarkable given that the smaller per mailing volume of this market segment prevents these customers from taking advantage of all private-sector worksharing opportunities that are available. These customers rely more on the effort of postal management to improve productivity and control costs. Higher productivity and correspondingly lower prices would have made this market segment grow even more rapidly.

To the extent that the Internet economy requires reasonably priced mail advertising to households for the growth of e-commerce competitors, the trends in the growth in Periodicals and Standard A to households is troubling. In contrast to the rapid growth of mail between nonhouseholds from 1992 to 1997, periodical volume to households declined by 27% in that period. Standard A volume to households rose by only 9% in the same period. For Standard A mail to households, this represents an annual growth of 1.6% a year.²⁹

The relatively slow growth rate of household delivery advertising and periodical mail raises serious concerns about increasing household delivery costs, particularly if the volume of First-Class mail declines as predicted,³⁰ and carrier wages and household delivery locations

²⁸ Data in the illustration is drawn from the 1997 Household Diary Study and the Annual Revenue, Pieces and Weights reports. In contrast to the rapid growth of the business between nonhouseholds between 1992 and 1997, periodical volume to households declined by 27% during this period.

²⁹Ibid.

³⁰ "US Postal Service, Challenges to Sustaining Performance Improvements Remain Formidable on the Brink of the 21st Century," Testimony of Bernard L. Ungar, General Accounting Office before the Subcommittee on the Postal Service, Committee on Government Reform, US House of Representatives, October 21, 1999, p. 4.

continue to rise. Worksharing does not provide an alternative to increasingly expensive Postal Service household delivery.

The second area where the Internet economy demands more service from the Postal Service and its competitors is in parcel delivery. Over the past decade, the transportation of parcels by ground and air carriers (including the Postal Service) has grown rapidly. In 1997, the Postal Service, United Parcel Service and specialized air carriers such as FedEx received nearly 7% of the nation's transportation budget. This increase represents a growth in market share for small shipments carriers of 98% from 1980 levels.³¹ During this period, the Postal Service's parcel business grew faster than that of its private sector competitors.

The best known names in Internet retailing, including Amazon.com, CD Now, E-bay, On-Sale.com, and Egghead.com, primarily ship parcels and large envelopes. Transportation and logistics costs are a significant portion of the total price they charge.

For example, Amazon.com is currently selling *Harry Potter and the Prisoner of Azkaban* for \$9.97. Shipping costs \$3.95, which represents nearly 28% of what a customer pays to purchase this book on-line. In 1999 Amazon.com used the Postal Service for 65% of deliveries.³² Improving Postal Service efficiency would benefit both the consumer and the shipper, and would increase postal revenues from parcel post.

³¹Small shipment transportation costs are estimated as the sum of the revenue of UPS ground service, air cargo service of specialized and scheduled carriers (including UPS), bus carriers, rail less than carload shipments and USPS Express Mail, Priority Mail, Parcel Post and Standard B Special products minus the Postal Service's air transportation costs. The Postal Service's air transportation costs are subtracted because they are included in the revenue of the air carriers. Sources: *Transportation in America*, Rosalyn Wilson, 1999. *Eno Transportation Foundation, Washington DC, Cost and Revenue Analysis report and Revenue, Pieces and Weight Report of the United Postal Service, 1990-1997.*

³² "Industry Leaders Discuss Postal Service Role in Internet Commerce," United States Postal Service Press Release, September 28, 1999.

9. POSTAL STAKEHOLDERS REQUIRE A DETAILED TIMETABLE FOR IMPROVING PRODUCTIVITY

The Mailers Council commends the Postal Service for recognizing the need for an aggressive program for productivity improvement. The Postal Service describes this program in some detail in its *Fiscal Year 2000 Performance Plan*. We believe this program would benefit from a timetable for specific actions that will achieve these goals. Without a public timetable, which must include new management incentives to achieve the long-term objectives described in this study, the Mailers Council believes the Postal Service will fail to reach the level of productivity improvements of the private sector that the Postal Service needs to achieve to survive.

Meeting aggressive productivity goals is increasingly important as the competitiveness of electronic and physical delivery competitors expands. The Postal Service forecasts that electronic alternatives will be an important factor in the expected decline in profitable First-Class mail. Electronic alternatives to the USPS could put as much as \$17 billion of total revenue at risk.³³ Postal observers agree that competitive pressures from the Internet, domestic carriers and foreign postal administrations will make the Postal Service's mission more difficult in the very near future. The Mailers Council believes one of the best ways for the USPS to face these challenges is by renewing its commitment to improving postal productivity.

New physical delivery competitors will include both foreign and domestic firms. FedEx is now testing home delivery and could threaten the Postal Service's lucrative Priority Mail business. Foreign postal administrations, including Deutsche Post (Germany), Royal Mail (Great Britain), and TNT Post Group (Netherlands) have invested significantly in US firms offering domestic mail production, distribution, transportation delivery and international mail acceptance and transportation. These foreign competitors have become the nonexpedited primary competitors for the distribution of documents internationally.

The Mailers Council believes that the public commitment must involve more than just improvements in measured labor and total factor productivity. In particular, productivity improvement requires an aggressive, public implementation timetable of programs the Postal Service may identify as helping it achieve its productivity goals. We are prepared to offer our opinions on those pilots the Postal Service is considering, and would gladly assist in implementing those approved for funding.

³³ Testimony of William J. Henderson, Postmaster General, United States Postal Service, before the Subcommittee on the Postal Service, Committee on Government Reform, US House of Representatives, October 21, 1999, p. 3.

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