

BEFORE THE
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Annual Compliance Report, 2020

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Docket No. ACR2020

**INITIAL COMMENTS OF THE
AMERICAN CATALOG MAILERS ASSOCIATION (ACMA)**

(February 1, 2021)

Pursuant to Commission Order No. 5796, “Notice of Postal Service’s Filing of Annual Compliance Report and Request for Public Comments,” December 30, 2020, ACMA is pleased to submit these comments.

I. Introduction.

The most fundamental assignment of the Postal Service is to provide the Nation “prompt, reliable, and efficient services”¹ for sending correspondence to addresses. To help make these services affordable, it has been given a monopoly. A century of effort to mechanize and automate has drawn a line between letter-shaped pieces and what we now know as flats. These two categories are complements, yet the unit mail

¹ See 39 U.S.C. § 101(a). Section 403(a) requires “fair and reasonable rates,” and 403(b)(1) requires “an efficient system of collection, sorting, and delivery.”

processing cost of Flats is 7.6 times the corresponding cost of Letters.² If the number of pages increases, mailers should not have to say: our letters morphed into flats, and we now face rates that are prohibitive.

For the most part, our members are senders of flats. We mail mainly in a mix of five Marketing Mail categories, which break out into 42 components and 126 rate elements.³ We are barred by the mailbox rule from the benefits of competition, so we must purchase from the Postal Service, if we purchase. We prepare mail according to regulations and turn it over to the Postal Service at the best entry points.⁴ We work on committees and task forces to help design and test improvements, at significant cost to ourselves. It is not working.

Consider for one thing that our rates have increased faster than the CPI, faster than factor prices, and faster than most other rates, yet the cost coverage of Flats is down to 63.20 percent, of Carrier Route is down to 95.99 percent, of High Density/Saturation is down to 129.57 percent, of Periodicals⁵ is down to 56.93 percent, and of

² The mail processing cost is 41 percent (Letters) to 57 percent (Flats) of total cost, and is relatively insensitive to average weight, 0.8 ounces for Letters and 4.0 ounces for Flats.

Herein: Marketing Mail = MM, MM Letters = Letters, MM Flats = Flats, and MM Carrier Route = Carrier Route or CR, the last three of which have been designated as products. Commercial and Nonprofit will be capitalized when a component of a product. Uncapitalized, letters, flats, carrier route, commercial, and nonprofit refer generally to non-product categories, usually to categories broader than products.

³ Detailed rates are shown in USPS Notice123, issued each time rates are changed. Regulations to go with the rates are provided in the Domestic Mail Manual.

⁴ Our determination of the “best” entry points is based on dropship signals in rates.

⁵ Periodicals is a flats category, primarily. In FY 2020, 0.38 percent of the Periodicals class was classified as barcoded/automation letters.

First-Class Flats, a category we consider but use sparingly, is down to 100.01 percent. Coverages for all of these products were much higher just a few years ago.⁶ Costs have clearly risen inordinately, as we will discuss *infra*. Since 1998, the volume of Commercial non-ECR flats has *declined* 83.4 percent, Nonprofit 46.0 percent.⁷ The corresponding figure for Outside County Periodicals is -78.6 percent. The flats portion of the Postal Service's assignment is crashing.

We will show that flats costs are either inefficiently incurred or lack the validity required to place reliance on them. An apparent lack of tightness means the costs as reported are unlikely to quantify an effect of volume changes. Reaching this conclusion does not require that new costs be available. A further consideration is that if the rates for flats continue to be pushed up, in hopes of achieving higher cost coverages, the outcome will be substantially lower flats volumes, even higher flats costs, and a relic flats processing capability. The Postal Service will have failed to provide a document service.

II. In the Flats Product, the Behavior of the Nonprofit Category Has Caused the Cost Coverage to Decline.

Title 39 § 3626(a)(6)(A) provides that nonprofit rates "shall be equal, as nearly as practicable, to 60 percent of the estimated average revenue per piece to be received

⁶ Unless otherwise indicated, data and analyses used in these comments may be found in the CRA (Library Reference 1 in various Compliance Reports), in the billing determinants (Library Reference 4 in various Compliance Reports), or on relevant tabs of ACMA_ACR2020_Workbook.xlsx, the latter filed concurrently with these comments.

⁷ ECR includes all categories as dense or more than Carrier Route. Excluding Saturation, ECR flats have declined less than 83.4 percent, but they use only a corner of the Postal Service's mail processing capability.

from the most closely corresponding regular-rate subclass of mail.” No attention is given to the “to be” phrase, which requires a forecast, and the “closely corresponding [] subclass” is being interpreted to be the *class*.⁸ Thus, a rate for a nonprofit flat could be set anywhere between zero and a corresponding commercial rate, and the 0.6 ratio could be arranged by adjusting other nonprofit rates. Of course, though apparently allowed by (6)(A), it would not be workable for a nonprofit rate to be *below* zero or *above* a sister rate.

But, even though the nonprofit rates are linked to the class, the cost coverage of Nonprofit Flats is part of the cost coverage of the Flats product. As a proportion of the per-piece revenue of Commercial Flats, the per-piece revenue of Nonprofit Flats has ranged from a high of 66.7 percent (in 2016) to a low of 60.3 percent (in 2019). These ratios reflect the rates set. Since 2008, Commercial rates have increased 31.2 percent while Nonprofit rates have increased only 22.4 percent. Volume changes have also had an effect. Since 2008, Commercial volume has decreased 73.1 percent while Nonprofit volume has decreased only 29.5 percent. As a result, Nonprofit volume as a proportion of Commercial volume has increased from 17.7 percent (2007) to 40.9 percent (2020). If Nonprofit was deemed negligible at one point, it cannot be so deemed now.

In short, the presence of Nonprofit volume in Flats pushes down the cost coverage for Flats, and the trends in rates and volumes have increased the magnitude of the push-down. Whether the rate decrement for Nonprofit continues to increase depends on decisions made by the Postal Service, but the differential negative trends in

⁸ This means that the closest subclass to Nonprofit Flats is the class, the closest subclass to Nonprofit CR is the class, and the closest subclass to HD/SAT is the class. One wonders why the logic of Euclid’s first axiom doesn’t require that all three have the same revenue per piece.

volumes are partly secular, and the differential may grow as higher rates discourage Commercial volume. This will leave Nonprofit as an orphan in Flats. These effects are not apparent from the aggregate numbers, but they are real.⁹

III. Cost Increases Are Continuing Unabated.

Cost coverages have been a ratio considered in Postal ratemaking. They are dimensionless and can be thought of as unit revenue divided by unit cost. In order to see the influence of cost changes, uninfluenced by changes in volume-mix, a volume-weighted cost index can be developed. In its Initial Comments in Docket No. ACR2011, ACMA showed that such an index is closely approximated by an index developed from a rate index and the cost coverages.¹⁰ In a number of proceedings, we have called this the ACMA unit cost index.

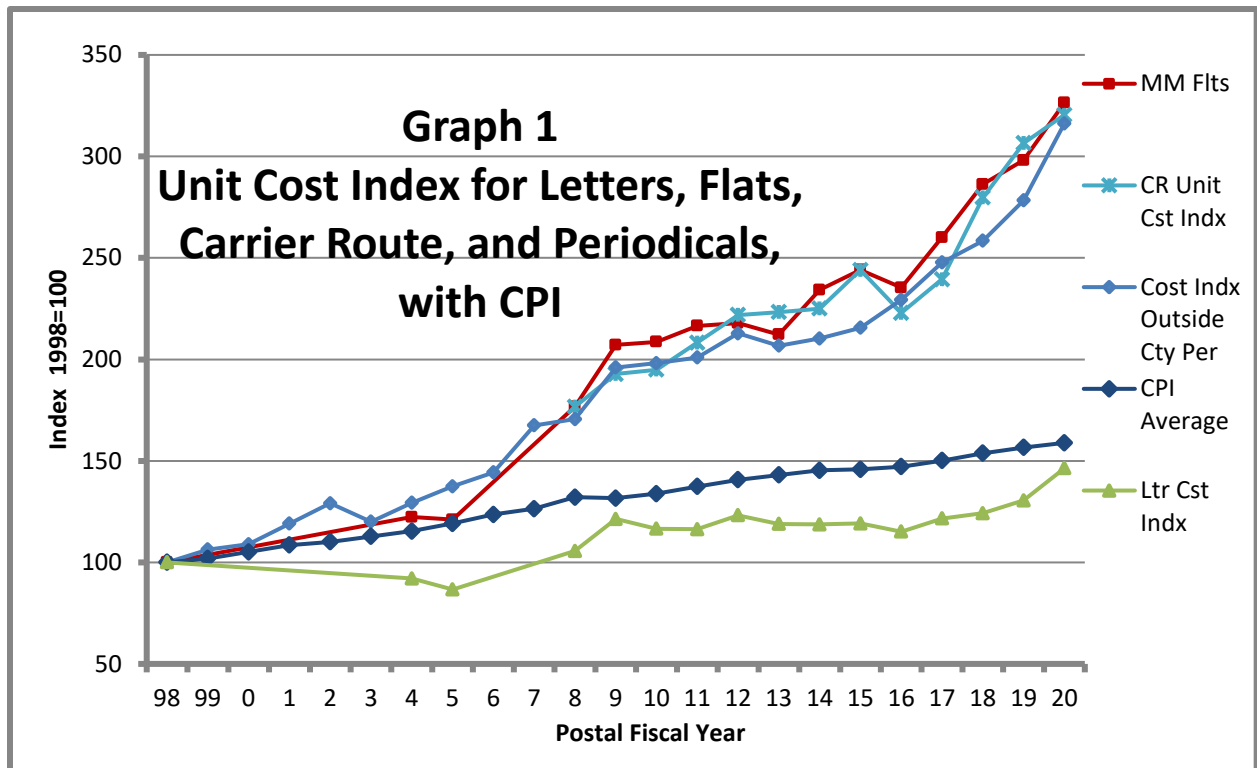
Using FY 1998 as a base, Graph 1 shows the unit cost index for Flats, Carrier Route, Periodicals, and Letters, along with an index of the CPI. Because data for Carrier Route are not available prior to 2008, the Carrier Route index is pegged to the Flats index at 2008.

⁹ The nature of a situation is often made clear by considering its limits. Here, if the rate increases for Nonprofit were held down and the Commercial volume were to dwindle, Nonprofit would be its own product and its coverage would be about 41 percent. This situation would definitely call for attention.

¹⁰ Note that both the rate index and the cost coverages are routinely available.

It is easy to see that a unit cost index might be approximated in this way. Because rates tend to follow costs, a shift to a higher-cost mix would tend to increase both the unit revenue and the unit cost, leaving the coverage unaffected. A change in coverage requires a change in unit costs or a change in rates, the latter quantified by the rate index.

Suppose the cost coverage is 103/90, and we know the rates increased 3 percent. The cost coverage without the rate increase would be 100/90. If 100/90 is a decrease, it must be because the unit cost increased.



To some extent, the unit cost of Letters has tracked the CPI. The increases for all three flats categories (Flats, CR, and Periodicals) are similar, as one might expect, but are disturbingly large. Since 2008, the unit cost of Flats has increased 226.4 percent, meaning that it is now 3.26 times its 2008 level. The CPI, however, has increased only 59 percent.

These cost increases can be stated in terms of average compound annual growth rates, which are shown in Table 1.

Table 1. Average Compound Average Growth Rates from FY 1998 and for FY 2020		
Category	Average Compound Annual Increase	FY 2020 Increase
Flats	5.52%	9.5%
Carrier Route	5.44%	4.5%
Periodicals	5.37%	13.6%
Letters	1.28%	12.1%
CPI	2.13%	1.4%

It is true that the volumes have declined and that some changes have been made in the analyses underlying the costs. But growth rates of this magnitude add up, like the miracle of compound interest. These increases suggest that something is wrong. Above-cap rate increases will make it worse. We should be benefiting from the investment in flats technology and from the kind of cost containment that is common under price caps, but we are not. Flats costs are out of control.

**III. The Costs of Five-Digit Automation Flats Are Too High
Relative to Carrier Route, and Are Higher Than They Should Be.**

Within Flats, the 5-d automation category is 48.2 percent of the volume. If the FSS volume is included, it is 64.7 percent. It is a natural for many bulk mailers, as 10 pieces for a 5-digit area is not an overly high hurdle. To inform workshare discounts, costs for 5-d auto are developed in Library Reference 11. These costs include both a piggyback factor and a CRA reconciliation factor, and are viewed as variable with

volume. Similar costs are developed for Carrier Route in Library Reference 18. Neither of these costs includes non-mail-processing costs, such as carrier costs and transportation. Pieces in both categories must get to carriers. City carriers case them and rural carriers handle them as they wish.

In 2007, on a per-piece basis, the cost of 5-d auto was 14.174 cents and the cost of Carrier Route was 4.432 cents, 5-d auto thus costing 9.74 cents more. In 2020, the cost of 5-d auto was up to 31.27 cents, a 120.6 percent increase, leading 5-d auto to cost 23.4 cents more than Carrier Route. The 5-d/CR differential is now 2.4 times as large as it was in 2007.¹¹

The processing required by these two categories, 5-d auto and CR, is both similar and a step different. Roughly, a CR bundle must be sorted to a container for the delivery unit, transported to the delivery unit, and sorted to the carrier's bin. A 5-d auto bundle must be sorted to an appropriate sorting machine, sorted to a container for the *carrier*, transported to the delivery unit, and sorted to the carrier's bin or near it. Relative to the CR pieces, then, the 5-d auto pieces receive one sort. One sort, even including prep, should not cost 23.4 cents.

The CR costs, the subtrahend in the 23.4-cent difference, are dropship adjusted, which means they are the mail processing costs as if all of the pieces were origin entered. To the extent that the 5-d costs are not so adjusted, the difference is higher. It may be noted that the volume has declined since 2007, but the costs here are in pools that are presumed to be 100 percent variable. If this is the case, a reduction in volume

¹¹ If 2006 is used, the 5-d/CR differential is 2.0 times as large.

should have no effect on the unit costs. If it is not the case, then the costs are too high and the costing needs to be adjusted downward.

Five-digit auto mail should be viewed as some of the most attractive mail the Postal Service receives—the services it needs are services the Postal Service should be well-positioned to provide. But its costs are too high. The picture here is not one of an efficient operation.

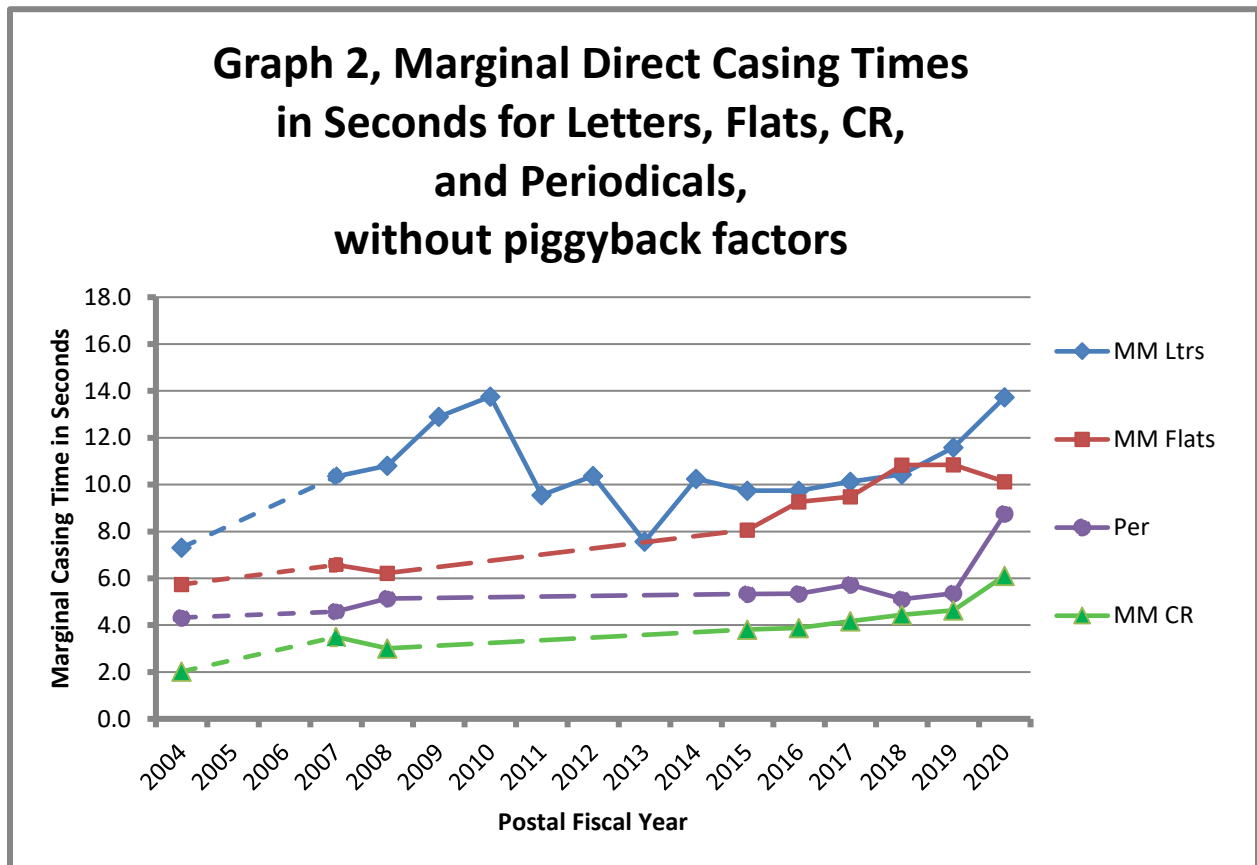
If these costs cannot be reined in, a way around them might be for the Postal Service to design and offer a low-cost 5-d service that is competitive. We do not know the best parameters for this, but the idea is to bring, to the DSCF, scheme-containers of 5-d flats that can be entered in a simple way into an appropriate sorter.

IV. The Costs of Casing Flats Suggest That the Casing Operation Is Not as Tight as It Should Be.

Most flats are delivered by City Carriers, and most of these are cased. Costs are estimated for direct casing, separate from both direct non-casing and in-office support. We looked at these costs for Letters, Flats, Carrier Route, and Periodicals. If the piggyback factors are omitted, the wage rates can be used to convert these costs into seconds of time.

Graph 2 shows the marginal casing times in seconds per piece for Letters and three categories of flats, for 2004 through 2020. The dashed lines indicate missing

intermediate points. For the three flats lines, we were unable to find the proportion sequenced on the FSS for 2009 through 2014.



In FY 2004, CR was about one-quarter letters and was in line-of-travel (LOT). An additional piece took 2.02 seconds to case. Periodicals at the time was 49.5 percent carrier route, and took 4.32 seconds. An additional Flat took 5.74 seconds. Without information on pieces per bundle, it is difficult to comment relatively on these times, but the relationships seem close to what one would expect—certainly the LOT status of CR, and of Periodicals at the 49.5 percent level, had an effect. An additional Letter, however, took 7.31 seconds, making it clear that something wasn't working right.

Now look at FY 2020. CR, now almost all flats, is up to 6.11 seconds, 3 times as high as in 2004. Periodicals, now up to 69.4 percent carrier route, is 8.75 seconds,

about twice its 2004 level. Flats is up to 10.13 seconds and Letters to 13.73 seconds. The picture painted is not one of an efficient casing operation. If the Postal Service were competing with other firms, it would be left behind. Before being attributed, these costs are inflated by direct non-casing costs, support costs, and a piggyback factor, so they have a substantial effect on total attribution. If they continue at this level or higher, and if rates follow, they will continue to drive out volume.

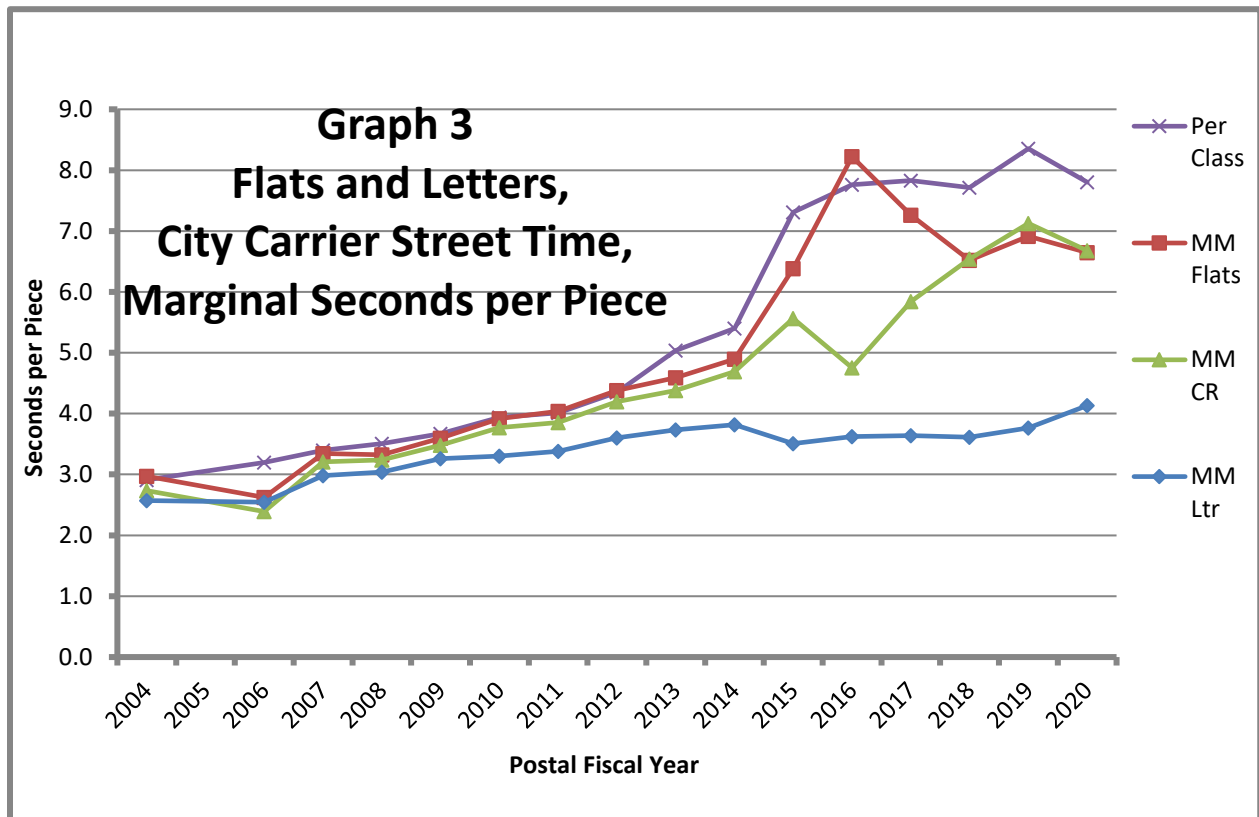
It is true that the volumes declined over the period shown in the graph. But the casing operation is viewed as 100 percent variable. Therefore, the volume level should have a negligible effect on casing time, if any. If volume *is* influential, the variabilities are too high, the attributable costs are too high, and the costing needs to be adjusted downward.

If we can be excused for using an in-vogue term, the design and management of in-office time needs to be *reimagined*. A second or two on billions of pieces is a considerable number of people and dollars. The Postal Service is putting itself out of business.

V. City Carrier Street Times Reflect a System in Disarray, and Are Too High.

City carrier street costs are designed to be marginal. That is, the per-piece cost is designed to be the additional cost of adding another piece, the latter of a rate-induced kind. We began with the cost of direct street activities and direct street support. We included the piggyback factor because it is designed to be aligned with marginal costing. We did not include any office time burdened on street, although it too is assessed as variable. We then used carrier wage rates to convert these costs into

seconds of time per piece, making it easier to compare them over time. The results are shown in Graph 3.



In 2004, the best estimate was that a Letter took 2.6 seconds, a CR piece took 2.7 seconds, a Flat took 3.0 seconds, and a Periodical took 2.9 seconds. The range from low to high was 0.4 seconds. Letters was the lowest, but only by a tenth of a second. Now, in 2020, Letters is up to 4.1 seconds (a 60.1 percent increase), Periodicals is up to 7.8 seconds (a 168.1 percent increase), and Flats and CR are almost the same at about 6.6 seconds (an increase of about 130 percent). The range from low to high is now 3.7 seconds, 9.1 times the range in 2004.

During the period, two costing changes occurred. The result of RM2020-7 was to increase Letters times by 0.086 seconds, decrease Flats times by 0.428 seconds, decrease CR times by 0.600 seconds, and reduce Periodicals times by 0.428 seconds.

These changes are small. Earlier, RM2015-7 reduced Letters times by 0.26 seconds and increased flats times by about 0.7 seconds. These were parts, but clearly small parts, of the increases that are shown for flats in 2015. The obvious misbehavior of the Flats and CR lines in the two years following 2015 was due to FSS volume shifting to and from Flats and CR. Also, volume declines occurred over the period. But, except for changes in route coverage (which would be large for an additional Saturation mailing and likely small for other mailings [because the addresses receiving mail are most likely to receive additional {rate-induced} mail]), we do not see that a volume decline should have a substantial effect on times.

Throughout the period, most Letters were DPS'ed, but somehow, these letters, at least on a marginal basis, took 60 percent longer to handle in 2020 than in 2004. About 20 percent of the flats were FSS'ed during the second half of the period. Whatever was happening, the times for flats are too high, are rising, and are in disarray. Rates built on these times will drive more volume away and not help the Postal Service.

Somehow, the delivery system is not designed and managed to present mailers with a low-cost, efficient delivery system. If competition were allowed, the Postal Service would be losing out.

V. Conclusion.

Firms incur costs because they purchase factors of production—generally they purchase labor, materials, supplies, services, and capital. If the prices of these factors increase, a firm can sometimes gain by changing the mix of factors purchased. It can also gain by making technological improvements, whether or not spurred by factor price

changes. Therefore, unless affected by volume changes, the *most* that unit costs should increase would be the average increase of factor prices.

As part of its TFP measurement effort, the Postal Service develops estimates of the average increases in factor prices. In 2020 relative to 2019, for example, factor prices increased 2.004 percent. Relative to 1998, factor prices are up 84.8 percent. During the same period, the unit costs of the three flats categories in Graph 1 increased about 220 percent, while the unit cost of the Letters category increased only 46 percent. We do not believe the effects of volume losses are large enough to overcome the effects of technological change and further to cause increases of this magnitude. And we would note in addition that, at no small cost to themselves, mailers have helped the Postal Service reduce costs by improvements in mail preparation.

As further evidence that the costs are out of control, we reviewed specifically the mail processing costs for 5-d automation flats, the casing costs of city carriers, and the street costs of city carriers. Our analysis shows that these costs are too high and lack tightness. It appears evident that a well-designed, well-managed, efficient system should allow much lower costs.

If rate increases are large enough to reflect these cost increases and to cover the costs of nonprofit mail, which, in the Flats category, covers about 41 percent of its costs, two things will happen: first, there will be a realignment in the use of the mail as many mailers of Marketing Mail find First-Class rates to be lower than their own; and second, flats volume will decline to the point that the Postal Service's flats processing capability

becomes a relic. This is not a good outcome and is doubtfully an outcome anticipated by the framers of the Postal Reorganization Act in 1970 or of any legislation since.

Respectfully submitted,

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