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BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON DC 20268-0001

POSTAL RATE AND FEE CHANGES, 2000) Docket No. R2000-1

SUPPLEMENTAL TESTIMONY OF LAWRENCE G. BUC

ON BEHALF OF

DIRECT MARKETING ASSOCIATION, INC.
ADVO, INC.
ALLIANCE OF INDEPENDENT STORE OWNERS AND PROFESSIONALS
ALLIANCE OF NONPROFIT MAILERS
AMERICAN BUSINESS MEDIA
ASSOCIATION FOR POSTAL COMMERCE
ASSOCIATION OF PRIORITY MAIL USERS, INC.
DOW JONES & COMPANY, INC.
FLORIDA GIFT FRUIT SHIPPERS ASSOCIATION
GREETING CARD ASSOCIATION
MAGAZINE PUBLISHERS OF AMERICA
MAJOR MAILERS ASSOCIATION
THE MCGRAW-HILL COMPANIES, INC.
PARCEL SHIPPERS ASSOCIATION
TIME WARNER INC.

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Testimony Should Be Addressed To:

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Autobiographical Sketch

My name is Lawrence G. Buc. My autobiographical sketch appears in my direct testimony in this case: DMA-T-1.

I. Purpose and Scope of Testimony

For this testimony, I reviewed the supplemental testimony of Richard Patelunas on behalf of the Postal Service in response to Postal Rate Commission Order No. 1294. (USPS-ST-44) Although the Postal Service has stated that Patelunas' estimates do not constitute a revision to its proposed cost and revenue estimates (and, by extension, to its revenue requirement) (Response of the United States Postal Service to OCA/USPS-ST44-8 redirected to the Postal Service), witness Patelunas provides the most current estimates of Test Year costs. Thus, it is important to review them and correct any errors and omissions. Further, if Patelunas' cost estimates are the basis for a revised revenue requirement, it is also necessary to explore the appropriate contingency to accompany these cost estimates.

In this testimony, I review the appropriate contingency given the method and timing of witness Patelunas' cost estimates and re-estimate the savings for the Advanced Flat Sorting Machine 100 (AFSM 100) that I presented in my direct testimony, based on flat sorting productivities for FY 1999. I conclude that the appropriate contingency to accompany the new Test Year estimates is one quarter of one percent and that savings from deploying the AFSM 100 are $402.4 million, an increase of $30.9 million over my previous estimate. The details of my analysis follow.

II. The Contingency Should be One Quarter of One Percent

My direct testimony in this case demonstrated that a one percent contingency was both reasoned and reasonable, given the evidence supporting the Postal Service's Revenue Requirement. I reviewed witness Patelunas' testimony to determine if he provided additional information which would change my analysis of the proper contingency. In light of his new cost estimate for the

Test Year, I believe that an even lower contingency – one quarter of one percent - is warranted. There are four reasons for reducing the contingency to this level.

First, shifting the basis of the wage increase for all employees whose contracts will expire during the Test Year and for non-bargaining unit employees from one percentage point less than the Employment Cost Index (ECI) to the ECI reduces the risk of unforeseen and unforeseeable expenses. Because the purpose of the contingency is to defray these unforeseen and unforeseeable risks, this reduction in risk should be reflected in a reduced contingency. Second, the Postal Service's additional cost reductions reflect neither the full savings that the Postmaster General has committed to achieving nor, following the Postal Service's revised response to Presiding Officer's Information Request 14, the full cost reductions in the FY 2001 budget. Thus, the risk of not achieving the expected cost reduction savings in the TYAR estimate is reduced. Consequently, there is a high probability that costs in the Test Year will be less than those the Postal Service has estimated. This should be reflected in a reduced contingency. Third, the simple timing of the new cost estimate reduces some of the risk inherent in the Postal Service's original cost estimate. This, too, should reduce the contingency. Fourth, the very exercise of the recalculation of TYAR costs shows that a smaller contingency is warranted. Following, I address each of these issues.

A. The Use of ECI for Wage Settlements Rather than ECI-1 Warrants a Smaller Contingency

In its original filing, the Postal Service used a percentage point lower than the ECI as an estimate of the percentage increase in pay that employees will receive whose contracts expire during the Test Year and for non-bargaining unit employees. Witness Patelunas has revised this estimate of the percentage increase to the ECI (USPS-ST-44 at 3), although he has provided no rationale for doing so.

Since estimates of inflation have increased between the time of the original and the revised filing (see Exhibit USPS-ST-44 AB), witness Patelunas is conceptually correct to use more recent estimates of the ECI as the basis of his forecast of TYAR costs. And costs that result from increases in the ECI, in contrast to those from changing the basis of the estimate from ECI-1 to ECI, are valid costs in revised TYAR estimates. By increasing the basis for the wage settlement and including these increases in the costs of the various cost segments, however, the Postal Service has reduced the risk to which it is exposed in new wage settlements by the same amount as it has increased its estimate of labor costs. Thus, the contingency should be reduced by this amount.

As an illustration, assume that the Postal Service had originally estimated that labor cost increases for those employees with agreements expiring in the Test Year would be $500 million. Because there is uncertainty in this estimate, part of the contingency can be thought of as reflecting this risk. Now, further assume that using the ECI assumption instead of the ECI-1 assumption, the revised labor cost increase for these employees is $700 million, or $200 million more than was previously estimated. Finally, now assume that the actual settlement will be $800 million.

Under the original request based on ECI-1, the actual settlement will be $300 million more than the estimate, so the Postal Service would have had unforeseen costs of $300 million. Under a revised request based on ECI, the settlement will be only $100 million more than estimated. Thus, unforeseen costs under a revised request are $200 million less than under the original request (the precise increase in labor costs) and the contingency should be reduced by this same amount.

I used Library Reference 421 to explore the cost consequences of using ECI rather than ECI-1. Specifically, I calculated cost level changes using both ECI and ECI-1, keeping everything else constant. Cost level changes appear in Acc_0r.xls. After establishing links between Uncst_est.xls and Input_0r.xls, the cost level changes using both ECI and ECI-1 flowed through to Acc_0r.xls. Results from this analysis are in Attachment DMA ST2-A. Table 1, below, shows that changing from ECI to ECI-1 increases costs by $246.6 million. The contingency must be reduced by this amount to reflect the reduction in risk.

TABLE 1: SUMMARY OF ANALYSIS OF CHANGES IN TYAR PERSONNEL COST LEVELS BETWEEN ECI AND ECI-1

($ 000)

Total Cost Level At ECI-1	Total Cost Level At ECI	Difference
[1]	[2]	[3]
$2,290,167	$2,536,809	$246,642

[1] Attachment DMA ST2-A.xls, 'Summary', cell C27.
[2] Attachment DMA ST2-A.xls, 'Summary', cell D27.
[3] Attachment DMA ST2-A.xls, 'Summary', cell E27.

B. Because Postal Service Cost Reduction Estimates are Lower than those the PMG has Committed to, the Contingency should be Reduced

Although the Postmaster General has committed in public to reducing costs in the Test Year by an additional one billion dollars over the amount in the Postal Service's January filing (See "Breaking Through to a New Golden Age of Mail" Remarks by William J. Henderson, Postmaster General/CEO United States Postal Service at the National Postal Forum, Nashville, Tennessee – March 20, 2000, Attachment DMA-ST2-B), witness Patelunas includes only an additional $544 million of cost reductions in his estimates. (Revised Response of United States Postal Service to Presiding Officer's Information Request No. 14, Item 2(b) and (e) Errata, response b) Thus, the Postal Service's cost reductions are $456 million less than those the Postmaster General has announced. When asked from the bench whether it was possible that the savings could be larger than reflected in his TYAR estimates, witness Patelunas responded, "It is possible. I said in one of the responses, it continues to evolve." (Tr. 35/16811)

Further, although cost reduction programs reflect many draft FY 2001 budget decisions, the cost reductions witness Patelunas has used in his cost forecast for TYAR as reflected in his Errata to POIR 14, are $200 million less than the cost reductions in the budget. If he had used the budget estimates of cost reductions, Patelunas confirmed that the revenue requirement would have been $200 million less. (Tr. 35/16812)

The purpose of the contingency is to provide for unforeseen and unforeseeable events; it is important to recognize that these events could have positive effects on costs rather than only negative effects. Given that the Postal

Service is committed to reducing costs beyond those levels estimated in its cost forecasts, as manifested in speeches by the Postmaster General and in the budget, the risk of actual costs that exceed estimates should be correspondingly less and the contingency should be reduced to reflect this fact. At a minimum, the contingency should be reduced by the $200 million of cost reductions that appear in the draft budget but not in the Postal Service's response to Order No. 1294. Phrased another way, the contingency should be reduced by $200 million of the $456 million that the Postmaster General has announced that the Postal Service will save but that are not in the Postal Service's filing in response to Order No. 1294.

C. The Timing of the New Cost Estimate Warrants a Smaller Contingency

The Postal Service filed the Supplemental Testimony of Richard Patelunas on July 7, 2000. Since the original request was filed on January 12, 2000, the original filing was about 8.5 months before the start of the Test Year while the Supplemental Testimony was filed less than three months before its start.

As forecasting horizons become longer, outcomes become more uncertain and the risk of an outcome lying well outside of the forecast increases. As forecasting horizons become shorter, outcomes become more certain and the risk of an outcome lying outside of the forecast decreases. The contingency should be reduced to reflect the reduction in risk given the new forecast.

D. The Postal Service's Re-estimation of TYAR Cost Shows that a Lower Contingency is Warranted

In a sense, Patelunas' revised TYAR cost estimate provides an experiment to determine the sensitivity of the deficiency with respect to changes in inflation rates. The experiment shows that the deficiency is not very sensitive to changes in inflation rates. As he shows, it is almost inconceivable that inflation could change enough to warrant even the 1 percent contingency I recommended in my direct testimony, much less the 2.5 percent contingency that the Postal Service requested. Consequently, the contingency should be reduced.

As witness Patelunas shows in Exhibit USPS-ST-44AB, there have been substantial increases in key inflation indices since the original filing (although the changes in the CPI-W and the ECI are not large enough to change the conclusions I drew in my original testimony.) Notwithstanding these changes in inflation rates and the choice of an upward revision in the wage settlement to ECI from ECI-1, the effect on net income is almost trivial.

In his testimony as originally filed, Patelunas calculates "a test year after rates deficiency of $275.3 million. This compares to ...a test year after rates deficiency of $21.8 million, reflected in the Request." (USPS-ST-44 at 8-9) Thus, the net effect of the re-estimation of TYAR costs, after adjusting to include the additional $200 million of Field Reserve as cost reductions, is to increase the TYAR deficiency by $253.5 million dollars. With an estimate of $67.190 billion for the Postal Service's original TYAR cost estimate (USPS-T-9 at 22), the increase in the revenue deficiency represents only 0.38 percent of the original TYAR cost estimate.

III. Using Updated Sorting Productivities from FY 1999 Increases AFSM 100 Cost Savings by an Additional $30.9 Million

In my direct testimony, as revised in response to USPS/DMA T-1-13, I estimated savings of $371.5 million in the Test Year from deploying the AFSM 100. In contrast, the Postal Service estimated savings of $169.4 million. (Tr. 22/ 9553)

I have revised my estimate of AFSM savings in the Test Year using available information on sorting productivities in FY 1999. Using exactly the same method as I used previously, but replacing sorting productivities from 1998 with those from 1999 (PostCom/USPS-ST43-6a redirected to USPS, Attachment 1 at 1), yields savings of $402.4 million, an increase of $30.9 million over my previous estimate. Attachment DMA ST2-C provides the derivation of my revised estimates. My estimate of savings remains conservative for all the reasons I cited in my direct testimony; further, I have not increased the estimate for the increased clerk and mailhandler wage rates in the Test Year.

The Postal Service has also revised their estimate of savings from the AFSM 100 by an additional $56.9 million. Table 2, below, compares the savings the Postal Service and I estimate in our direct cases and the savings we estimate under Order 1294 revisions.

TABLE 2: AFSM 100 COST SAVINGS
TEST YEAR AFTER RATES

	Direct Case ($ 000)	Order 1294 Revision ($ 000)
USPS	$169,379[1]	$226,237[2]
DMA	$371,510[3]	$402,421[4]

1 DMA, et al-T-1, Attachment C, page 1.
2 USPS AFSM cost savings (see footnote 1) + Comparison of Original to Updated Cost Reductions (Exhibit USPS-ST-44Z) +Comparison of Original to Updates Other Programs (Exhibit USPS-ST-44AA) ($169,379+ ($83,335-$7,895-$15,058-$3524))
3 DMA, et al-T-1, Attachment C, page 1.
4 Attachment DMA ST2-C.

SUMMARY OF ANALYSIS OF CHANGES IN TYAR PERSONNEL COST LEVELS

EEN ECI AND ECI-1

($ 000)

	COST SEGMENT	TOTAL COST LEVEL AT ECI-1	TOTAL COST LEVEL AT ECI	DIFFERENCE
		[1]	[2]	[3]=[2]-[1]
1	Postmasters	$ 73,689	$ 74,038	$ 349
2	Supervisors and Technical Personnel	137,436	138,082	646
3	Clerks & Mail Handlers, CAG A-J (Incl SDMsgrs)	854,859	1,033,369	178,510
4	Clerks, CAG K Post Offices	430	524	94
6&7	City Delivery Carriers	861,413	862,416	1,003
8	Vehicle Service Drivers	21,375	26,005	4,630
				-
10	Rural Carriers	181,496	217,178	35,683
11	Custodial & Maintenance Services	107,547	128,916	21,369
12	Motor Vehicle Service	13,815	16,485	2,671
13	Miscellaneous Local Operations	2,066	2,146	81
14	Purchased Transportation of Mail	-	-	-
15	Building Occupancy	-	-	-
16	Supplies and Services	712	811	99
17	Research & Development	-	-	-
18	Headquarters and Area Administration	35,210	36,717	1,507
19	Equip. Maintenance & Mgt Tng. Spt.	121	122	1
20	Depreciation, Write-offs, Losses, & Interest	-	-	-
	Total	**$ 2,290,167**	**$ 2,536,809**	**$ 246,642**

[1] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_0r.xls, 'Est. Year 2'. Change made in Uncst_est.xls, 'COLA-ECI', cell D53 to decrease the value of the FY 2001 Percent Change by 1.0%.

[2] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_0r.xls, 'Est. Year 2'.

ANALYSIS OF CHANGES IN PESONNEL COST LEVELS BETWEEN ECI AND ECI-1
($ 000)

COST SEGMENT		SALARIES							
		CARRYOVER COSTS - PAY			PAY			STEP/MERIT	
		ECI-1	ECI	CHANGE	ECI-1	ECI	CHANGE	ECI-1	CHANGE
		[1]	[2]	[3]=[2]-[1]	[4]	[5]	[6]=[5]-[4]	[7]	[9]=[8]-[7]
1	Postmasters	12,245	12,245	-	39,917	40,211	294	-	-
2	Supervisors and Technical Personnel	22,648	22,648	-	73,779	74,322	543	-	-
3	Clerks & Mail Handlers, CAG A-J (Incl SDMsgrs)	23,303	23,303	-	214,370	344,698	130,328	50,413	(309)
4	Clerks, CAG K Post Offices	12	12	-	116	186	70	12	(0)
6&7	City Delivery Carriers	47,063	47,063	-	301,897	302,684	787	39,199	-
8	Vehicle Service Drivers	622	622	-	5,517	8,961	3,444	623	(22)
				-			-		-
10	Rural Carriers	12,751	20,777	8,027	33,636	55,412	21,776	5,421	61
11	Custodial & Maintenance Services	4,292	4,292	-	29,962	45,893	15,931	2,884	(101)
12	Motor Vehicle Service	607	607	-	3,953	5,944	1,991	361	(13)
13	Miscellaneous Local Operations	271	271	-	944	1,005	61	10	(0)
14	Purchased Transportation of Mail	-	-	-	-	-	-	-	-
15	Building Occupancy	-	-	-	-	-	-	-	-
16	Supplies and Services	55	55	-	256	330	74	13	(0)
17	Research & Development	-	-	-	-	-	-	-	-
18	Headquarters and Area Administration	4,430	4,430	-	15,617	16,753	1,135	185	(6)
19	Equip. Maintenance & Mgt Tng. Spt.	20	20	-	67	67	0	-	-
20	Depreciation, Write-offs, Losses, & Interest	-	-	-	-	-	-	-	-
	Total	**128,321**	**136,347**	**8,027**	**720,030**	**896,465**	**176,435**	**99,120**	**(391)**

[1], [4], [7], [10], [13], [16] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_0r.xls, 'Est. Year 2'. Change made in Uncst_est.xls, 'COLA-ECI', cell D53 to decrease the value of the FY 2001 Percent Change by 1.0%.

[2], [5], [8], [11], [14], [17] - USPS-LR-I-421 Order No. 1294/Rollforward Expense Factors (Patelunas), Acc_0r.xls, 'Est. Year 2'.

ANALYSIS OF CHANGES IN PESONNEL COST LEVELS BETWEEN ECI AND ECI-1 (CONT.)
($ 000)

BENEFITS									TOTAL CHANGE
ROLLUP PREMIUM			ROLLUP LI, RET, TSP			ROLLUP SS, MED			
ECI-1	ECI	CHANGE	ECI-1	ECI	CHANGE	ECI-1	ECI	CHANGE	
[10]	[11]	[12]=[11]-[10]	[13]	[14]	[15]=[14]-[13]	[16]	[17]	[18]=[17]-[16]	[19]=[3]+[6]+[9]+[12]+[15]+[18]
2,418	2,432	14	5,372	5,402	30	4,134	4,145	11	**349**
4,472	4,498	25	9,936	9,992	56	7,754	7,775	21	**646**
99,096	123,276	24,179	62,018	77,321	15,303	36,494	45,503	9,009	**178,510**
42	52	11	33	41	9	17	22	5	**94**
100,429	100,567	139	72,259	72,259	-	40,825	40,902	77	**1,003**
2,034	2,565	531	1,666	2,101	435	929	1,172	243	**4,630**
		-			-			-	**-**
5,415	6,431	1,017	10,253	12,906	2,653	9,665	11,814	2,149	**35,683**
9,666	12,116	2,450	8,335	10,351	2,016	4,598	5,672	1,073	**21,369**
1,221	1,527	306	1,073	1,325	252	598	731	134	**2,671**
84	93	9	141	148	7	102	105	4	**81**
-	-	-	-	-	-	-	-	-	**-**
-	-	-	-	-	-	-	-	-	**-**
52	63	11	53	63	9	32	37	5	**99**
-	-	-	-	-	-	-	-	-	**-**
1,449	1,614	164	2,357	2,497	140	1,695	1,768	74	**1,507**
4	4	0	9	9	0	7	7	0	**1**
-	-	-	-	-	-	-	-	-	**-**
226,382	**255,238**	**28,856**	**173,504**	**194,414**	**20,910**	**106,849**	**119,654**	**12,804**	**246,642**

March 20, 2000 - REMARKS BY POSTMASTER GENERAL AND CEO WILLIAM HENDERSON AT THE POSTAL FORUM - NASHVILLE, TN

FOR IMMEDIATE RELEASE

Breaking Through to a New Golden Age of Mail

Remarks by William J. Henderson,
Postmaster General/CEO United States Postal Service
at the National Postal Forum
Nashville, Tennessee - March 20, 2000

At National Postal Forum in Chicago, I told you that my job is to make you successful. I also talked about the Postal Service's trusted presence as the Gateway to the Household. And we talked about what we call the mail moment - the time when the mail arrives and everybody stops what he or she is doing to read it.

I promised you that - even under the pressures of the digital age - we would do everything in our power to keep the mail relevant. I promised that we would focus on the quality and value of our core products. That we would reduce costs and manage efficiently. That we would ensure that the mail moment does not lose its power and value to our nation.

We have delivered. We delivered more than 200 billion pieces of mail to 130 million households and businesses over the past year, the most in our history. Our standard of service has never been higher. Everyone from America's established business community to its emerging dotcoms continues to rely on our ubiquitous presence and universal service to promote their images, improve their sales, and secure their revenues.

Mail is relevant in the digital age because it reaches every address. Michael Dell, the founder and chief executive of Dell Computer, recently told me that his catalog mailings account for the largest percentage of his sales of personal computers. He understands the power and value of our Gateway. So do many others.

Studies by Pitney Bowes say that two-thirds of the e-business companies they surveyed believe that mail is the best medium for developing long-term customer relationships. Seven out of 10 use direct mail to promote their web sites and to attract new customers.

K-Mart -- another of our partners represented in this Forum -- has rediscovered success by revitalizing its direct mail marketing programs to drive customers into their stores and traffic to their Website.

All of these companies - and you -- value our tradition, trust, reliability, reach, ability to meet needs, and affordability. Those are the pillars on which the Gateway rests and on which you in the mailing industry have built your businesses. They make the mail powerful. Significant. Relevant.

The Three Challenges: Affordability, Mail Industry Growth, and Reforming the Regulatory Environment

But, as we look for ways to leverage the successes of the Postal Service and the mailing industry in the future, we have arrived at a crossroads.

Keeping the mail and our businesses relevant in the future is not guaranteed.

Our continued relevancy will require new ideas, new business models, and a commitment to the traditions that helped turn the 90s into a "Golden Age of Mail."

Together, we must master three critical challenges:

- First, keep the mail affordable.
- Second, grow the mail industry.
- Finally, reform the regulatory environment.

Let me expand on these challenges - and more important - what the Postal Service is doing to meet them.

We have to continue our transformation of the Postal Service into the supplier of choice for high-quality, low-cost products and services. We have to be affordable.

We have to bring our internal cost structure down and restrain prices. That is the only way we will survive as key segments of our letter mail volume migrate to electronic messaging.

Of all the pillars supporting our Gateway, affordability is the one that threatens to bring the whole house down.

But, this is not just a Postal Service issue. It is not just about the price of postage. It is about your businesses, too. It is about the combined cost of conceiving, producing, preparing, collecting, and delivering that mail piece.

When the total investment in that moment costs AT&T $1.75 a piece, or Safeway $1 a piece, who can blame them for looking to the promise of e-business for lower transaction costs? We have to be concerned about that.

Cost cutting alone, however, will not secure our future. No company, no industry, will grow solely on its ability to cut costs. So, our second challenge is to create new business models, new products, and new streams of revenue to assure that the mailing industry grows. Opportunities for growth lie in the global embrace of e-commerce; there is no question about that. But don't write off hard copy mail just yet.

There is still tremendous value and visibility in First-Class Mail. People still want to touch and read their publications. Advertising mail, for the reasons we have already talked about, is a strong medium. E-business presents growth opportunities for Express Mail, Priority Mail, and packages. And, the worldwide economy is an invitation to greater use of international mail products.

The third challenge we face is regulatory reform. Regulation constrains us from fully realizing our potential to operate in a businesslike manner. Our ratemaking process supports a cost-based, rigid pricing system that keeps us from being able to reward customers for their loyalty, cooperation and confidence in the mail. It stimulates unrest and dissatisfaction within the mailing community.

Nearly five years of debate about postal reform - in the Congress, in the Postal Service, and in the mailing industry - has failed to get us the flexibility we need. We also need freedom to invest our income, and some way to bring the voice of the customer into labor arbitration. We needed reform five years ago; we need it today.

Breakthrough Productivity: The Key to Cost Control

Saying that we face tough challenges is not the same as having a plan to address them. We have a plan, and we have been aggressively pursuing it for the past five years.

We will continue to take bold actions.

We are building a culture of operational excellence. We have been at it for several years, and we already have driven billions of dollars of costs out of the system. Looking forward, I have instructed my team to launch additional initiatives that will reduce our expenses by at least $4 billion by 2004. This is above the billion dollars we cut in 1999, and it is a target for which we will all be accountable.

Some of the savings will come from overhead reductions, about $100 million a year. We have completed a comprehensive study of activities and transactions, and over the next several months will be moving to centralize support functions, to eliminate duplication, and to achieve reductions in administrative staffing.

One hundred million dollars annually will come from more efficient paperwork and purchasing. Another $100 million a year will come from reducing transportation costs. We will use more ground transportation, and better deploy the contract capacity we have. We also can reduce steps in the distribution and handling of mail.

But the lion's share of these reductions -- some $700 million a year -- will come from dramatic, breakthrough productivity in our processing system.

Breakthrough productivity means reducing costs through everything from machine utilization, to standardized processes, to staffing and scheduling, and to resource management.

Breakthrough productivity means tracking mail throughout the system. It means benchmarking, measuring performance, and understanding the costs of every activity. Over the course of this year, you will see the introduction of more key features of our

Information Platform, including Confirm/Planet Codes for letter mail and flats, Signature Confirmation to augment Delivery Confirmation, and other systems to allow both of us to manage the mail and reduce costs.

Breakthrough productivity also means managing our capital investments in line with changes in our volume patterns, our need to create new products and channels, and investing in the next generation of automation for flats and parcels to offset the cost of labor.

Our breakthrough has begun. Our present rate of total factor productivity improvement is ten times higher than the annual average we achieved for the past decade. Total factor productivity rose to 2.3 percent in the final quarter of 1999. It is 2.1 percent year to date, and 2.6 percent in the second quarter.

At the same time, over the past two years, we have slashed more than $1.5 billion in expenses to compensate for lagging revenue. The hallmark of that effort has been carefully controlling the size of our workforce. Already, 11,000 career vacancies have been absorbed through attrition, and that number will reach at least 20,000 as we move forward.

To put that in perspective, we will eventually eliminate positions from our organization equal to the combined workforces of a Quad/Graphics and a Fingerhut. Or, to pose it another way, the jobs that will disappear are roughly equivalent to the total number of postal workers in the state of Tennessee, plus Rhode Island.

Growing the Mail Industry: The Source of New Revenue

Even with productivity-boosting measures this extreme, we are barely keeping our heads above water. We are facing declining margins, and we have presented you with a rate case.

This was an agonizing decision for us, and it was traumatic for many of you. But perhaps more importantly, it is clear that cutting costs is not a stand-alone strategy for preventing rate increases in the future.

We must help you to grow your industry. Our efficiency and our productivity are volume-driven. We have to have volume and its associated revenue to thrive in the future. There simply isn't any other way. You have my commitment that we will continue to strengthen our core products. We will leverage what we have, and we will work to put the new technologies of e-commerce to work for you.

Already -- all day, every day -- our customers can use our on-line services to buy stamps and postage, confirm delivery and arrange for package returns, get ZIP Code information, locate post offices, and order Priority Mail and Express Mail supplies.

But, we also are confronted with the disruptive side of technology. Technology lowers the hurdle rate for competition to enter any market. It cannibalizes for-fee services, and offers them to consumers for nothing. It creates new business models. Its potential for global ease of access in our markets challenges our very understanding of universal service.

So, we intend to introduce Web-based services consistent with our mission and financial prudence. We are evaluating several now. We have talked about them before. Electronic postmarks, bill presentment and payment, and electronic mailboxes for those who want them are all technically feasible. These are electronic services that enhance our core products, keeping mail -- and the mailing industry -- relevant, reliable, and vital.

Regulatory Reform: An Absolute Requirement

For all of the promise that is there, we are going to wind up with an inferior Postal Service in the future if we do not change the regulatory environment. If you read current business literature -- or a week's worth of the Wall Street Journal -- you know that there are others who can move faster, can act more agilely and can better respond to changes in the marketplace.

We need commercial freedoms, including market-based pricing and the ability to generate income for investment.

Whether we call it deregulation, privatization, or liberalization -- whatever label you choose -- the lines between public and private providers of postal products and services are blurring. We must be able to compete fairly and to act in concert with the needs of our customers, or somebody else will.

Other posts are already realizing the potential of commercial freedoms. In Canada and Germany, in the Netherlands and Sweden, in New Zealand and Australia, commercial freedoms are allowing postal services to aggressively come to terms with our new business environment. They are free to invest, able to enter into forward-looking pacts with labor and encouraged to seek out partnerships, alliances and new markets.

Now, we cannot talk about costs and growth and reform and pretend that there's not an elephant in the room. H.R. 22 is a balanced approach to postal reform. We support it. But it does not address your voice in the labor process.

Under the law, your voice is represented in ratemaking by 14 members of the presidentially appointed Board of Governors and Postal Rate Commission. As a practical matter it is often an independent arbitrator, who is called on to make wage decisions that affect hundreds of millions of dollars in labor costs.

Let me be clear that I am not being critical of our unions. They, like we, are operating within the law -- and frankly, sometimes things go labor's way, sometimes they go management's way.

How we resolve this problem is uncertain, but we remain open to a dialogue with our unions about this and other ways that we can create incentives for employee innovation and breakthrough productivity without breaking the bank. I think our union leadership understands the stakes. They know we cannot forge a new "Golden Age of Mail" if we kill the golden goose that is our core business.

Success Requires Commitment and Partnership

To summarize, we have an aggressive plan for tackling the challenges we face. It recognizes that without affordability and growth, your businesses will suffer with ours. It recognizes the importance of commercial freedoms.

I don't want to be flippant about this, but you're either with us, or you're against yourselves.

Our futures, our successes are that entwined.

Obviously, some of the changes we seek will not come easily. But the stakes are high, and we must continue to put stakes in the ground as a Postal Service, as an industry, and as committed partners.

I say again, our job is to keep you successful, and keep the mail relevant. We will do our part. That is a commitment I make to you on behalf of our Management Committee, our Officers and our organization.

We will deliver.
You have my word on it.

AFSM 100 Savings Comparison

AFSM 100 Cost Savings Comparison - REVISED 06/16/2000
(all numbers in thousands)

	DMA	USPS	Difference
	[1]	[2]	[3]=[1]-[2]
Total Savings	$ 402,421	$ 169,379	$ 233,042

Sources:
[1] Attachment C, pg 2.
[2] Attachment C, pg 3.

USPS AFSM 100 Clerks Test Year Savings

Clerks Workhour Savings (hours)	Hourly Clerk Wage Rate	Clerks Workhour Cost Savings (thousands)
[1]	[2]	[3]=[1]*[2]
6,052,003	$ 27.99	$ 169,379

Sources:

[1] Docket No. R2000-1, Tayman, Tr. 2/322.

[2] Docket No. R2000-1, USPS-LR-I-126, PRG_ANAL-revised.xls, 'Data'. Hourly wage rate obtained from dividing Clerk/Mailhandler Avg. Personnel Cost (50,125) by Workhours Per Workyear (1,791).

DMA AFSM 100 Clerks TY Savings

DMA AFSM Clerks Test Year Savings - REVISED 07/31/2000 - Using PFY 1999 Data

		[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]
		Direct Cost per Handling (cents)	Plant/Delivery Unit Manual IS Factor	AFSM Productivity (units/hour)	Number of Machines	Operational Hours per Workday	Operational Days per Year	Total Sorts Per Year (millions)	Allocated Sorts (millions)	Total Cost Savings
IS	IS - Manual, Plant	7.261	26.10%							
	IS - Manual, Delivery Unit	3.339	73.90%							
	IS - AFSM 100	0.941	N/A							
	Difference*	3.421		15,000	166.5	20	313	15,634	5,882	$ 201,210

		Direct Cost per Handling		AFSM Productivity (units/hour)	Number of Machines	Operational Hours per Workday	Operational Days per Year	Total Sorts Per Year (millions)	Allocated Sorts (millions)	Total Cost Savings
IP	IP - FSM 881 OCR/BCR	3.005								
	IP - AFSM 100	0.941								
	Difference**	2.063		15,000	166.5	20	313	15,634	9,752	$ 201,210

TOTAL SAVINGS **$ 402,421**

Sources:

* Difference (IS only) is calculated by taking 26.10% of the difference between IS - Manual, Plant and IS - AFSM 100 added to 73.90% of the difference between IS - Manual, Delivery Unit and IS - AFSM 100 per Docket No. R2000-1, LR-I-90, R2000_1_Flats Cost Model_Final USPS.xls, 'Data', Plant/Delivery Unit Manual IS Factor.

** Difference (IP only) selected as conservative estimate as smallest difference between cost of current sort and cost of AFSM 100 sort.

[1] Docket No. R2000-1, LR-I-90, R2000_1_Flats Cost Model_Final USPS.xls, 'Mailflow Model Costs', Cents per Piece Handling, with a modification to set a volume variability factor equal to 1.00.

[2] Docket No. R2000-1, LR-I-90, R2000_1_Flats Cost Model_Final USPS.xls, 'Data', Plant/Delivery Unit Manual IS Factor.

[3] Docket No. R2000-1, LR-I-90, R2000_1_Flats Cost Model_Final USPS.xls, 'Productivities', Footnotes [7] and [8]

[4] LR-I-83, page I-12

[5] Kingsley, TR.5/1961.

[6] Kingsley, TR.5/1960.

[7] = [3]*[4]*[5]*[6]

[8] = Allocated Sorts is the number of sorts allocated to each scenario to yield equal cost savings, Kingsley, TR.5/1660.

[9] = [8]*[1]