

BEFORE THE  
POSTAL REGULATORY COMMISSION  
WASHINGTON, D.C. 20268-0001

Priorities for Future Data Collection and )  
Analytical Work Relating to Periodic Reporting )

Docket No. RM2011-3

**VALPAK DIRECT MARKETING SYSTEMS, INC. AND  
VALPAK DEALERS' ASSOCIATION, INC.  
INITIAL COMMENTS ON PRIORITIES FOR FUTURE  
DATA COLLECTION AND ANALYTICAL WORK RELATING TO  
PERIODIC REPORTING  
(February 18, 2011)**

On November 18, 2010, the Commission issued Order No. 589, Notice and Order of Proposed Rulemaking on Periodic Reporting. This docket is the first strategic rulemaking following Docket No. RM2008-4 to “develop an inventory of longer-term data collection and analysis needs, comprehensively evaluate these needs, and devise a plan for meeting these needs....” Order No. 589, p. 2. The Commission attached five “candidate areas for improvements in data collection and analysis” to Order No. 589, and set February 18, 2011 as the deadline for initial comments.

Valpak Direct Marketing Systems, Inc., and Valpak Dealers' Association, Inc. submit the attached paper of John Haldi, Ph.D., as their initial comments and suggestions for research and improvement in data collection. That statement proposes four areas for research: (i) re-examining systemwide cost volume variability from a macro perspective; (ii) defining and quantifying excess capacity; (iii) defining and quantifying short-run marginal costs; and (iv) developing a single measure of service performance reliability by product.

The last topic addressed in the attached paper deals not with cost issues, but with an issue that will arise from the service performance reporting system once it begins operating

successfully. It is unclear as to whether this proposal is within the scope of this docket, as

Order No. 589 appears to be focused exclusively on cost issues:

Finally, the Commission's periodic data reporting rules currently have placeholders for data required to calculate the **cost** of the Postal Service's Universal Service Obligation (*see* 39 CFR 3050.30) and data required to estimate the **quality of service** (*see* 39 CFR 3050.53). These topics will be addressed in **separate dockets**. [*Id.*, p. 4 (emphasis added).]

However, Order No. 589 in this docket quotes Order No. 104 (Aug. 22, 2008) as follows:

A strategic rulemaking ... might list existing **analytical studies** that need to be updated, or new analytical studies that need to be undertaken. The scope of a strategic rulemaking would be **broad**, since one of its purposes would be to compare the likely cost and benefits of improved data or analysis in different areas of research, and the lead time required to conduct the research. [Order No. 589, p. 2 (emphasis added).]

Therefore, Order No. 104 implies that analytic issues other than cost might be contemplated within the scope of a strategic rulemaking.

Respectfully submitted,

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## **SUGGESTIONS FOR DATA COLLECTION AND ANALYSIS**

Docket No. RM2011-13

February 18, 2011

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This paper, prepared for Valpak Direct Marketing Systems, Inc. and Valpak Dealers' Association ("Valpak"), suggests, for the Commission's consideration, four areas for research relative to the Commission's Order No. 589 in the above-referenced docket. Three of these suggestions relate to costs, and one pertains to performance measurement.

### **I. RE-EXAMINE SYSTEMWIDE COST VARIABILITY FROM A MACRO, OR TOP-DOWN, PERSPECTIVE.**

The attachment to Order No. 589 suggests five candidate areas for improvements in data collection and analysis. All five pertain to volume variability. This suggestion also pertains to volume variability, but from a somewhat different perspective.

#### **A. Introduction.**

For many years mail volume grew and the Postal Service expanded. Most existing estimates of volume variability were developed during that growth phase. The conclusion that mail processing costs are 100 percent variable with volume derives generally from the macro observation that mail processing costs expand in tandem with mail volume, and not from any detailed micro study.

In recent years, though, the Postal Service has suffered substantial declines in mail volume.<sup>1</sup> Between FY 2006 and FY 2010, volume declined by 20 percent, with yet further declines in mail volume projected.<sup>2</sup> Largely in response to this reduction in mail volume, the Postal Service has made a number of significant adjustments to its operating plan, with the commendable result that operating costs and employment also have been reduced by record-breaking amounts. *See, e.g.*, Docket No. ACR2010, Valpak Initial Comments, section I. These recent events offer an unprecedented opportunity for a broad-ranging study of volume variability in a downsizing phase, as opposed to the prior growth phase.

**B. Advantages of a Broad Macro Perspective.**

Labor-related costs comprise approximately 80 percent of all Postal Service costs. In aggregate, the total number of employees appears to have been somewhat more variable with respect to volume than generally has been acknowledged. As might be expected, employment has not declined in lockstep with falling volume, but has tended to lag behind the decline in volume. (Such lags have been referred to as “stickiness.”) Nevertheless, the correlation between volume and employment can be seen clearly in multi-year data. For example, the 20 percent decline in mail volume between FY 2006 and FY 2010 was accompanied by a 16.4

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<sup>1</sup> *See* United States Postal Service (“USPS”) 2010 Annual Report, p. 82. *See also* Docket No. R2010-4, Statement of Joseph Corbett, p. 11 (July 6, 2010).

<sup>2</sup> *See* Docket No. R2010-4, Statement of Steven J. Masse. *See also generally* the 2011 Integrated Financial Plan, and the USPS 2010 Annual Report.

percent reduction in the number of career field employees and a 15.6 percent reduction in total employees (including non-career field employees).<sup>3</sup>

Employment in every category of career field employees exhibits a reduction (*see* Table I-1, *infra*). Although some of the observed decline in employment could be the result of factors other than the decline in mail volume, certainly the bulk of that response properly may be attributable, either directly or indirectly, to the decline in volume. For example, some of the decline in labor cost ostensibly may be the result of “restructuring.” But in the Postal Service, restructuring is driven by mail volume. In fact, the concept of long-run attributable costs assumes that facilities and the labor force will be restructured, as necessary, to optimize operating efficiency. Thus, cost reduction from restructuring driven by a decline in volume is properly included in a macro study of volume variability

Costs of overhead units now classified as institutional may be linked to mail volume in ways not documented in existing cost models. For example, the jobs (and cost) of many people not directly involved in mail-handling operations nevertheless may be related to mail volume, from nurses to area office personnel, and possibly even to headquarters personnel. Interestingly, significant percentage reductions have occurred in areas where costs have been presumed to be largely fixed.<sup>4</sup> Employment of clerks, mail handlers, and carriers declined by

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<sup>3</sup> USPS 2010 Annual Report, pp. 82-83. This downsizing in aggregate employment suggests a “gross” volume variability for labor as high as 80 percent.

<sup>4</sup> For instance, area offices and professional administration and technical personnel declined by 22.8 and 30.6 percent, respectively. Both percentage declines exceeded the 20 percent decline in volume. Also, the number of city carriers declined by 14.4 percent during this 5-year period, despite an increase in the number of city delivery points of 1,696,618 (2.0 percent), while full-time rural carriers declined 22.6 percent against an increase

17.3 percent, while employment of others declined by 12.4 percent (*see* Table I-1). This suggests a need to re-examine variability not only within individual cost segments and cost pools, but also on a systemwide basis.

A macro analysis based on large aggregates and time series data, such as suggested here, can provide a useful check on econometric studies that focus narrowly on individual cost segments and cost pools. Cross-section data that reflect mostly short-run changes can conceal longer-run adjustments that are an integral part of attributable cost. Volume variability revealed by a macro study might collaborate the detailed econometric analysis of individual cost segments and pools. If so, that would help substantiate the micro analyses. Alternatively, a macro analysis might indicate that volume variability of costs is 80 percent, whereas the detailed cost models indicate a volume variability of only 60 percent. Any such wide disparity would dictate an urgent need for more research, especially as regards linkages between individual components of the cost models restricted to individual cost pools or components of cost segments.

### **C. Pertinent Data.**

Time series data for each cost segment and component, supplemented as appropriate by data for individual cost pools, could all be revealing. The focus should be on the way in which total Postal Service costs have changed with the decline in mail volume. Cost reductions should be presumed linked to changes in volume unless contradicted by other facts. Results

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in rural delivery points of 2,725,712 (7.3 percent). *See* USPS 2010 Annual Report, pp. 83-84.

from a study such as that envisioned here would provide a useful check on isolated studies that focus exclusively on individual cost segments.

A proper analysis of the sort discussed here would relate changes in volume to changes in the number of hours worked, not just the number of employees. When studying how changes in volume relate to changes in cost over time, it may be appropriate to take into account changes in wage rates during the period studied. There are factors other than volume that over time can impact changes in work hours and cost. Those include changes in the level of presortation and further deployment of automated equipment, which should be taken into account.

Table I-1

## Career Field Employees, 2006 and 2010

|  | 2006    | 2010    | Change  | Percent Change |
|--|---------|---------|---------|----------------|
| Clerks   | 213,920 | 157,168 | -56,752 | -26.5          |
| Mail Handlers  | 57,158  | 48,650  | -8,508  | -14.9          |
| City Delivery Carriers                                 | 224,400 | 192,180 | -32,220 | -14.4          |
| Rural Delivery Carriers, full-time                     | 66,344  | 66,845  | -19,499 | -0.8           |
| Subtotal   | 561,822 | 464,843 | -96,979 | -17.3          |
| Area Offices   | 1,395   | 1,079   | -319    | -22.8          |
| Postmasters / installation heads                       | 25,429  | 23,111  | -2,318  | -9.1           |
| Supervisors / Managers                                 | 33,201  | 27,792  | -5,409  | -16.3          |
| Professional Administration and<br>Technical Personnel | 8,539   | 5,926   | -2,613  | -30.6          |
| Nurses   | 186     | 0       | -186    | -100.0         |
| Motor Vehicle Operators                                | 8,715   | 7,413   | -1,302  | -14.9          |
| Build and Equipment<br>Maintenance Personnel           | 39,986  | 37,403  | -2,583  | -6.5           |
| Vehicle Maintenance Employees                          | 5,521   | 4,985   | -536    | -9.7           |
| Subtotal   | 122,972 | 107,709 | 15,263  | -12.4          |
| Total Field Employees                                  | 684,774 | 572,552 | 112,222 | -16.4          |

Source: USPS 2010 Annual Report, p. 83.

## **II. QUANTIFY EXCESS CAPACITY.**

### **A. Introduction.**

This docket presents an excellent opportunity for the Commission to address the subject of excess capacity, hopefully before the Postal Service files a request for yet another short-term price incentive program in either First-Class or Standard Mail. It is important because excess capacity, if and when it exists, opens the entire existing costing system to a serious, fundamental challenge. And any such challenge is not likely to be overcome, or answered, by refinements or updates to the existing costing system.

The topic of excess capacity has been mentioned on a number of occasions in various proceedings before the Commission, but it has received little formal recognition until recently. On May 1, 2009, the Postal Service filed Docket No. R2009-3, the first so-called “summer sale” for Standard Mail. In that docket, the Postal Service stated, for the first time, that it had extensive excess capacity. Subsequently, in Docket Nos. R2009-5 and R2010-3, the basis for temporary rate reductions was the assertion yet again by the Postal Service that excess capacity was available. Certain parties now assert that excess capacity is widely prevalent throughout the postal network. It is a subject that needs to be studied, not speculated about. Following are illustrations of how “excess capacity” is beginning to permeate dialog on postal matters.

#### **1. Docket No. RM2010-9.**

In Docket No. RM2010-9, initial comments filed on July 16, 2010 by (i) the Saturation Mailers Coalition and Valassis Direct Mail, Inc., (“SMC/VDM”) and (ii) the Public Representative (“PR”) each mentions excess capacity. Their immediate concern was price

incentive programs, and the issue of estimating incremental cost when determining incremental profits

**a. SMC/VDM's Initial Comments.** The portion of SMC/VDM's Initial Comments where excess capacity is discussed is as follows:

As the Commission has noted previously, a discount will always generate more volume than otherwise, all else equal, and if the revenue from the additional volume is greater than the additional cost, such discount can lead to greater contribution to institutional costs. Any time the additional revenue exceeds the additional cost, there is an economic efficiency gain. That gain is even greater **if the additional volume takes advantage of "excess capacity"** in the system **that would go unused without the discounts.** [Docket No. RM2010-9, SMC/VDM Initial Comments, pp. 1-2 (emphasis added).]

SMC/VDM thus broach the topic of additional cost as it relates to excess capacity. They seemingly take excess capacity as a well-defined, well-understood phenomenon, and fail to expound on any of its implications and ramifications.

**b. The PR's Initial Comments.** The PR raises the issue of "excess capacity" in somewhat more detail, and offers a quick critique of the way it is "defined" by the Postal Service:

In most of the Pricing Incentive Programs offered by the Postal Service ... the Postal Service has claimed reduced marginal cost on incentivized pieces. Accurately capturing this reduced cost is essential to estimating the value of the incentive. In the case of **excess capacity**, due to either secular or seasonal causes, it is important to develop the marginal cost of the incentivized pieces through econometric models similar to those used in the ACR process. In response to R2009-3 CHIR No.1, the Postal Service stated that, "there is and will continue to be **material excess capacity** in city carrier street activities and operational experts are confident the additional volume caused by the Standard Mail Volume Incentive Program can be handled without incurring

additional city carrier street time costs.” This **qualitative analysis** forces an inaccurate estimation of the cost function and will lead to a less accurate estimation of incremental profits. [Docket No. RM2010-9, PR Initial Comments, p. 4 (emphasis added).]

The PR notes that, to date, all analysis, or “evidence,” concerning excess capacity has been of a **qualitative** nature, and recommends that adjustments to costs for analytic purposes (*e.g.*, for determining profitability of incentive programs) be the subject of a rulemaking.

## 2. Docket No. ACR2010.

Even more recently, in joint comments filed on February 2, 2011 by Magazine Publishers of America, Inc. (“MPA”), Alliance of Nonprofit Mailers (“ANM”) and American Business Media (“ABM”), the following statement appears:

The **excess costs** are attributable not to Periodicals mail but to the actions of Postal Service management and labor that have made the processing of flat-shaped mail a **disguised relief program for surplus mail processing capacity that would otherwise be unemployed**. The Postal Service needs to deal with this problem not through rate increases but through improved cost control. Moreover, until the **excess capacity** is eliminated, the Commission needs to treat the costs of the surviving **excess capacity** as institutional rather than attributable to the mail classes where the **excess capacity** is dumped.

In the meanwhile, the Commission need not worry that Periodicals mail imposes a burden on the Postal Service or other mailers. In FY 2010, Periodicals mail covered its short-run attributable costs, which, during **periods of excess capacity**, are much lower than the attributable costs reported in the Cost and Revenue Analysis (“CRA”). [Docket No. ACR2010, Initial Comments of MPA, ANM, and ABM, pp. 2-3 (emphasis added).]

Failure to define the term “excess capacity,” in the context of determining costs, facilitates naked assertions of this sort.

**B. Issues Related to Excess Capacity.**

Excess capacity clearly is a variable phenomenon, depending on circumstances. In the first summer sale docket (Docket No. R2009-3,) the Postal Service claimed to have excess capacity in the delivery force, and in the second summer sale docket (Docket No. R2010-3) it stated that excess capacity in delivery no longer existed. The bulk of the excess capacity claimed by the Postal Service has related largely to the labor force, and much less to the capacity of its fixed investment in plant and automation equipment. Since labor accounts for about 80 percent of total cost, it is appropriate that excess capacity in such a major cost component be the focus of concern. At the same time, excess labor capacity can and will change through attrition, layoffs, and re-assignment.

To date, schedules for the incentive dockets have been on a “fast track.”

Consequently, in none of them have questions concerning excess capacity such as those shown below been addressed by the Postal Service or the Commission.

1. The Postal Service never estimated **how much** excess capacity existed at the time any of its incentive proposals were submitted, hence no estimate was made concerning how much additional volume would exhaust such excess capacity.
2. The Postal Service did not state **how long** the excess capacity was expected to exist. The termination date of any incentive program was not tied to an estimate of when excess capacity no longer would be available to process additional volume submitted under the incentive program.
3. How does the Postal Service determine that some labor “is excess”? There have been reports of clerks and mailhandlers being assigned to special “resource rooms” to sit and do nothing, sometimes for the entire day.<sup>5</sup> If true, any such workers clearly are excess for those hours during each day when they are sitting

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<sup>5</sup> See G. Carlstrom, “Paid to do nothing: 11,000-plus postal workers idle at any given time,” *Federal Times* (Sept. 7, 2009).

idle. Does the Postal Service data system record the number of hours during which workers are assigned to do nothing each day? And how does the Postal Service estimate the number of workers likely to stay in such an “unemployed” or “semi-employed” capacity? Or the length of time that each one is expected to be in such less-than-fully-utilized capacity? During periods when workers are assigned to a “resource room,” should any of their cost be attributed to individual products? If so, on what basis? And on what theory of causality is such attribution based? Are any workers not assigned to the “resource room” also considered excess.<sup>6</sup> If so, how does the Postal Service determine the number who are excess among those not in the “resource room”? And if some workers not in the “resource room” are considered excess, should their cost be attributed to individual classes of mail? Can the In-Office Cost System (“IOCS”) be redesigned so as to capture explicitly information related to the possible existence of excess capacity? If so, should it be so redesigned?

4. Is piggybacking applicable to excess labor capacity? For instance, if it is estimated that 5 percent of clerks and mailhandlers (cost segment 3) are excess, does it follow that 5 percent of superintendents (cost segment 2) also are excess, regardless of whether such supervisors are assigned to sit in the “resource room”?

### **C. Definitional Issues Related to Excess Capacity.**

Although the term “excess capacity” is encountered with increasing frequency, the fact is that it has no clear definition ready for implementation in any data-gathering effort. Thus, before any meaningful data collection can begin, there needs to be a careful definition of what it is that the data seek to capture.

An example may help illustrate the point. As a hypothetical, suppose a major snow storm paralyzes transportation into and out of New York City for two or three days. As a result of the snowstorm, virtually no mail arrives from outside the city. And even within the

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<sup>6</sup> Periodicals mailers have claimed for years that the Postal Service often has mail clerks sort publications manually in order to keep them busy, and out of the “resource room”. Many years ago, Halstein Stralberg coined the term “automation refugees” to describe such workers.

city, many citizens do not make it to work, so local originating mail also is light. At the same time, because New York has a good underground transportation system, the vast majority of clerks and mail handlers show up for work, and those who do make it in are guaranteed eight hours of work. Consequently, for those two or three days, until the snow is cleared and things get closer to normal, the post office has far more employees than it needs to process the available mail.<sup>7</sup>

Is there excess capacity in the above hypothetical? Of course there is. Absolutely. And it may be possible to design a data system that captures it accurately, either through IOCS tallies, or otherwise. But when mailers complain they are being “victimized” by excess capacity, it seems unlikely that this is the type of situation to which they refer. However, if the data system accurately captures short-run temporary excess capacity of the type described here, it can present a problem because these data will have to be distinguished from other data that more accurately represent the sort of excess capacity about which mailers complain.

As described in one of the questions above, on occasion during the Great Recession, a number of postal workers reportedly have been assigned to sit in “resource rooms” and do nothing much for all of the day. This clearly is a good example of excess capacity, and to design a data collection system that would record such hours should not be too difficult.

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<sup>7</sup> Sometimes only a fine line exists between “waste and extravagance,” and a highly useful strategic reserve. During the summer of 2010, Mayor Bloomberg laid off a significant number of employees in the Sanitation Department (thereby reducing waste and inefficiency). When the snow came in January 2011, however, the Sanitation Department was unable to clear the streets for several days. Former Mayor John Lindsay suffered a similar fate (and residents of Queens did not forget). And in Chicago, failure to clear the streets after a major 1979 snowstorm helped Jane Byrne upset the incumbent and become mayor. “Those who cannot remember the past are condemned to repeat it.” Santayana.

Far more challenging is what periodical mailers have dubbed “automation refugees,” loosely defined as a number of clerks manually sorting periodicals when far fewer might process those same publications on automated equipment, at lower cost. A significant problem is that, for a variety of reasons, some periodicals are not machinable, and must be sorted manually. Any data system seeking to capture “excess capacity” in this situation would have to distinguish somehow between manual sortation when (i) it is not necessary and (ii) it is necessary, because the magazines themselves are not machinable. The former may reflect some degree of excess capacity, whereas the latter clearly does not.

If the subject of excess capacity is to be studied, this definitional task must be faced early on, and it will be challenging.

#### **D. Data Pertinent to Excess Capacity.**

Only after the phenomenon in question has been carefully defined does it become feasible to examine existing data systems to ascertain whether they contain any information that might be used to estimate excess capacity. If no usable information exists in any of the Postal Service’s extensive data systems, as seems likely, it then becomes necessary to design a system for obtaining the desired information.

### **III. DEFINE AND QUANTIFY SHORT-RUN MARGINAL COSTS.**

#### **A. Introduction.**

The concept of short-run marginal cost is well-established in economics. In the context of postal ratemaking, short-run marginal costs have been mentioned from time to time by various parties, but until recently never have been taken too seriously. During FY 2009,

however, the Postal Service itself suggested that its short-run marginal costs were less than the longer-run attributable costs, and on that basis proposed a temporary “summer sale” for Standard Mail. A “sale” also was held for presort First-Class Mail, and again in FY 2010 for Standard Mail. Postal Service proposals for these “sales” were reviewed and approved by the Commission, and that has helped bring the concept of short-run marginal costs onto the stage, front and center. References to short-run marginal costs have begun to proliferate. Mailers of products significantly underwater would prefer nothing more than to see short-run marginal costs be the basis for attribution all year, every year. Acceding to such desires could reduce the level of attribution substantially, thereby ratcheting up the share of costs classified as institutional.<sup>8</sup>

Nevertheless, use of short-run marginal costs has been proposed by the Postal Service and approved by the Commission on three occasions.<sup>9</sup> Under the circumstances, it is not unreasonable to be prepared for future Postal Service submissions that include short-run marginal costs as an integral component. Moreover, it is not unreasonable to hypothesize that proposals to use short-run marginal costs might arise in the context of negotiated service agreements (“NSAs”). There may be a proper time and place for use of short-run marginal costs, but they should not be used without further study.

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<sup>8</sup> As Valpak noted previously, long-run mischief seems to be the most likely result of approving use of short-run costs for summer sales. *See* Docket No. R2010-4, Reply Comments of Valpak, pp. 16-19.

<sup>9</sup> Docket Nos. R2009-3, R2009-5, and R2010-3.

**B. Definition of Short-Run Marginal Costs.**

Cost and Revenue Analysis (“CRA”) costs are calculated to reflect longer-run attributable costs. Over 99 percent of attributable costs are classified as volume variable, with only a few specific fixed costs also attributed. However, any acknowledgment by the Postal Service concerning the existence of excess capacity inevitably gives rise to assertions that short-run marginal costs are less than CRA costs. Short-run marginal costs appear to be fundamentally linked to the topic of excess capacity. In fact, it may not be possible to develop a workable definition of short-run marginal costs without first finding a way to measure excess costs reliably.

Aside from generalities such as “costs that vary in the short-run constitute short-run marginal costs,” workable definitions within the context of the Postal Service’s 20 cost segments simply do not exist. Nor can IOCS tallies be said to have any direct relationship to short-run marginal costs.

Another definitional problem concerns the term “short-run.” It could mean costs that vary only in some short-run period of time — *i.e.*, a period that is not “permanently” short-run — as opposed to longer-run attributable costs, which allow the Postal Service to adapt to an optimal configuration over time. But if it is a settled issue that short-run costs will not be used for attribution all year, every year, then short-run costs must refer to some kind of short-run period, such as a temporary, anomalous situation. Thus, there is not only a question of what costs to include (or exclude) when measuring short-run marginal costs, but also over what period of time as defined by certain conditions, *e.g.*, the existence of excess capacity.

### C. Measuring Short-Run Marginal Costs

Using its own ad hoc “qualitative” methodology, the Postal Service has computed short-run marginal costs for Standard Mail on an *ex post* basis following the 2009 and 2010 summer sales.<sup>10</sup> Results are shown in Table III-1, *infra*. Short-run marginal costs varied quite substantially from one year to the next; *see* Table III-1, columns 3 and 4. The short-run marginal cost of saturation letters reportedly increased by over 100 percent, and the short-run marginal cost of saturation flats and parcels reportedly increased by almost 200 percent. These results are not based on any accepted costing methodology, as no such methodology exists. The extent to which such wide variation reflects some change in methodology, versus a change in “facts” (*e.g.*, a diminution in excess capacity), has not been explained by the Postal Service. Issues concerning how short-run marginal costs are quantified should be worked out well in advance of any subsequent use.

For products in Standard Mail, Tables III-2 and III-3, *infra*, compare attributable costs in FY 2009 and FY 2010 to the short-run marginal costs for each respective year shown in Table III-1.

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<sup>10</sup> The Postal Service did not provide a computation showing short-run marginal costs for the other classes of mail or other products that were not on sale during those periods.

Table III-1

Standard Mail Products  
Short-Run Marginal Costs

|   | (1)<br>Docket<br>R2009-3 | (2)<br>Docket<br>R2010-3 | (3)<br>Increase | (4)<br>Percent<br>Change |
|---|--------------------------|--------------------------|-----------------|--------------------------|
| High Density and Saturation Letters         | 0.026                    | 0.055                    | 0.029           | 112.6%                   |
| High Density and Saturation Flats & Parcels | 0.022                    | 0.064                    | 0.042           | 192.6%                   |
| Carrier Route                               | 0.082                    | 0.145                    | 0.063           | 77.3%                    |
| Standard Regular Letters                    | 0.061                    | 0.087                    | 0.027           | 44.4%                    |
| Standard Regular Flats                      | 0.297                    | 0.369                    | 0.072           | 24.4%                    |

Sources: (1) Docket R2009-3, FY 2009 Summer Sale Data Collection Report, spreadsheet Calc.SR Att Cost for Summer Sale.xls (filed 2/26/2010).  
(2) Docket R2010-3, Summer Sale Data Collection Report, spreadsheet Cal.SR.AC.SS.FY10.CRA.xls (filed 12/29/2010).

In FY 2009, using short-run marginal costs in lieu of attributable costs would have resulted in an astonishing percentage reduction; *see* Table III-2, column 4. In FY 2010, the reduction was merely very large, ranging from 12 to 18 percent; *see* Table III-3, column 4. This reduction was a result of the year-to-year increase in short-run marginal cost discussed *supra*. If the Postal Service used a consistent methodology in FY 2009 and FY 2010, that needs better documentation.

Table III-2

Standard Mail Products  
Attributable and Short-Run Marginal Costs, FY 2009

|   | (1)<br>Attributable<br>Costs | (2)<br>Short-run<br>Costs | (3)<br>Decrease | (4)<br>Percent<br>Change |
|---|------------------------------|---------------------------|-----------------|--------------------------|
| High Density and Saturation Letters         | 0.063                        | 0.026                     | 0.037           | -58.4%                   |
| High Density and Saturation Flats & Parcels | 0.067                        | 0.022                     | 0.045           | -67.1%                   |
| Carrier Route                               | 0.160                        | 0.082                     | 0.078           | -48.8%                   |
| Standard Regular Letters                    | 0.109                        | 0.061                     | 0.048           | -44.0%                   |
| Standard Regular Flats                      | 0.448                        | 0.297                     | 0.151           | -33.6%                   |

Sources: Col. (1) Docket ACR2009, USPS-FY09-1, Public Cost & Revenue Analysis Report.

Col. (2) Table III-1, Column 1, *supra*.

Table III-3

Standard Mail Products  
Attributable and Short-Run Marginal Costs, FY 2010

|   | (1)<br>Attributable<br>Costs | (2)<br>Short-run<br>Costs | (3)<br>Decrease | (4)<br>Percent<br>Change |
|---|------------------------------|---------------------------|-----------------|--------------------------|
| High Density and Saturation Letters         | 0.064                        | 0.055                     | 0.009           | -14.3%                   |
| High Density and Saturation Flats & Parcels | 0.073                        | 0.064                     | 0.009           | -11.9%                   |
| Carrier Route                               | 0.165                        | 0.145                     | 0.020           | -12.4%                   |
| Standard Regular Letters                    | 0.106                        | 0.087                     | 0.019           | -17.7%                   |
| Standard Regular Flats                      | 0.448                        | 0.369                     | 0.079           | -17.7%                   |

Sources: Col. (1) Docket ACR2010, USPS-FY10-1, Public Cost & Revenue Analysis Report.

Col. (2) Table III-1, Column 2, *supra*.

**D. Issues Related to Short-run Attributable Costs.**

A host of questions arises from any use of short-run marginal costs for attribution (or for an ad hoc evaluation restricted to estimating profitability of some particular initiative or program). If excess capacity actually existed over some relatively short-run period of time (*e.g.*, the summer, which typically has been a slack season for mail volume), should attribution to all products (or to the entire volume of selected products) during that period be based on an estimate of short-run marginal costs, rather than CRA costs? And if a sudden drop in mail volume should result in excess capacity for a longer period (*e.g.*, six months to a year), should CRA costs be replaced by an estimate of short-run costs for that entire period?<sup>11</sup> If short-run costs ever again are going to be considered applicable to any volume of mail over any period of time, the Commission should consider giving much more rigorous definition to (i) how short-run costs are defined and quantified, (ii) the period over which short-run costs will be applicable, and (iii) the mail volume to which short-run costs will be applicable.

Replacement of existing attributable costs with short-run marginal costs would eviscerate the concept that each class or type of mail service pay, as a minimum, the costs which it causes the Postal Service to incur. Rate setting then would become even more arbitrary, potentially undermining any business model that aims for a financially self-sustaining Postal Service.

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<sup>11</sup> From time to time, the way that costs are attributed in the CRA has been criticized, perhaps justifiably in some cases. However, “progress” hardly consists of replacing attributable costs arbitrarily with short-run marginal costs not supported by any accepted methodology.

#### **IV. DEVELOP A SINGLE MEASURE OF PERFORMANCE RELIABILITY FOR EACH PRODUCT.**

##### **A. Introduction.**

At present, the service performance reporting system has serious problems in obtaining reliable data. These problems are explained in Docket Nos. RM2011-1, RM2011-4, and RM2011-7, all of which are pending. Hopefully, the Postal Service will move aggressively to resolve those problems. Once that occurs, a veritable plethora of useful data should become available. A variety of issues concerning the proper use and interpretation of those data may then arise. We deal with one here.

##### **B. Background: Desirability of a Single Measure for Reliability.**

The proxy for **speed of delivery** is the percentage of mail within a product that is delivered on or before the established target number of days. Mail is either delivered by the target date, or it is not. For each reportable product or sub-product, the result is a single measure for speed of delivery.

With respect to **reliability**, the matter is more complex. Order No. 465 requires the Postal Service to submit performance data showing for each product the cumulative percentage delivered within 1, 2, and 3 days of the established delivery date. These data (when finally reported on a regular basis) will be the measure of (or proxy for) reliability. With respect to an individual product, one clear issue concerning reliability is whether delivery in year X was more or less reliable than it was in the prior year, X-1. That is, from one year to the next, did reliability improve, or deteriorate? The question seems clear enough, but the answer can be ambiguous.

A hypothetical can help illustrate the potential ambiguity that is involved. Suppose performance data for product Y in two successive years are as follows:

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Table IV-1

Cumulative Percentage of Product Y  
Delivered Within Time Shown

| Year | On-time | 1 day<br>late | 2 days<br>late | 3 days<br>late |
|------|---------|---------------|----------------|----------------|
| X    | 83      | 88            | 90             | 93             |
| X-1  | 80      | 85            | 91             | 96             |

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Now, with the above data before us, assume the following dialog at a Congressional hearing with a witness from either the Postal Service or the Commission.

- Q: Was the service received by Product Y more reliable last year than the year before?
- A: It depends.
- Q: Depends on what?
- A: Well, on the one hand, if you look at how much of Product Y was delivered on-time, or within 1 day, service was better than the year before.
- Q: And on the other hand?
- A: If you look at the percentage of Product Y delivered within 2 or 3 days of the target, this year was not as good as last year.
- Q: And how late was the mail not delivered within 3 days? Either last year, or the year before?
- A: We don't know.
- Q: So what's happening to reliability? Is it getting better?
- A: We don't know. It may be getting better. At least we hope it is.

The preceding uncertain answers refer to a single product. If one inquires about reliability for Standard Mail, which contains six different products, the plot thickens. If one cannot provide more certain answers for a single product, then aggregating six products, each with results as diverse as those in Table IV-1, can be a daunting challenge. However, if a

clear, agreed-upon measure of reliability for each product existed — even if imperfect — then one could envision a weighted average of reliability for the six products combined. Lacking that, any evaluation of reliability will continue to be muddled.

### **C. Research.**

The research recommended here would consist of (i) defining a variety of different possible single measures of reliability, then (ii) identifying the strengths and weaknesses of each, and, finally, (iii) selecting one for purposes of presentation.

#### **1. Defining Single Measures of Reliability.**

This first step is conceptual and theoretical. By way of illustration, one possible single measure would be the cumulative percentage of mail delivered no later than three days of the established delivery standard, *i.e.*, focus on the cumulative percentage delivered by Day 3 and disregard the percentages delivered 1 and 2 days late. Referring to Table IV-1 above, by this rather simple, single measure, reliability in year X would be considered worse than reliability in the previous year X-1 — *i.e.*, 96 percent in year X-1 was better than 93 percent in year X. And if for each of the six products in Standard Mail we had a similar table, the volume of each product could be used to construct a weighted average for the entire class, and the weighted average could be compared for year X readily with the weighted average for the prior year, X-1.

Another way to construct a single measure would be to average the three numbers for 1, 2, and 3 days late in each year. Using the numbers in Table IV-1 again to illustrate, the average for year X-1 is 90.67, and the average for year X is 90.33. Based on these averages, and we would say that reliability in year X was slightly worse than in the previous year, X-1.

A single reliability measure can be developed in still other ways. Statistical measures of reliability typically involve variance. These clearly need to be investigated. However, standard variance measures, such as standard deviation, typically are “two-sided” measures. The reporting system established by Order No. 465 is “one-sided.” It only will report data on the tail-of-the-mail, *i.e.*, mail not delivered on or before the established target date.<sup>12</sup>

Some proposed measures of reliability might rely solely on the cumulative percentage data as presented in Table IV-1 *supra*. Others, though, might want more information on when mail **not** delivered within three days of the established standard was actually delivered — *i.e.*, “beyond” the tail-of-the-mail not disclosed by Table IV-1. Taking a large data base and mapping it into a single measure of reliability can be a challenging task. It is not the purpose here to advocate any particular result. The point is that this conceptual phase alone could take many weeks or months.

## **2. Identifying Strengths and Weaknesses.**

No single measure of reliability is perfect. Each will have strengths and weaknesses. Some criteria for evaluating different proposed measures might be (i) simplicity, (ii) understandability by the public (including Congress and staff), (iii) ease of computation, and (iv) comprehensiveness in terms of data included or excluded by each measure. Another consideration is to assume that:

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<sup>12</sup> If accurate data were available on mail delivered before the target date, one conceivably could give credit for such early delivery, *i.e.*, let early delivery of some mail offset late delivery of other mail. Of course, when dealing with advertising matter in Standard Mail, some mailers have a target window and prefer not to have their mail delivery before or after that window. In such instances, early delivery would not be a “plus.” This illustrates some of the complexity that needs to be considered.

- (i) decision-makers pay considerable attention to reliability as measured for each product,
- (ii) the entire field staff are aware of the measure used for reliability, and
- (iii) employees in the field want to “game” the system so as to look as good as possible, and then inquire as to the incentives embedded in each measure. For instance, if employees in a city or region focus intensively on timely processing and delivery of mail that originates and destines locally, would that (i) help them “look better,” and (ii) have a deleterious effect on outgoing mail to other areas? Previous attempts at performance measurement are known to have been susceptible to attempts to game those systems so as to get more favorable results.

More likely than not, it will be useful to test each proposed measure against a variety of actual data sets, such as the performance data for First-Class Mail, Periodicals, Standard Mail, and Package Services. This sort of empirical testing, although advisable, can be time-consuming.