



The Honorable Edward J. Gleiman Speech

Before the

Association of Priority Mail Users, Inc.

September 28, 1999

Good morning.

I'm flattered that so many of you have taken a pass on this morning's Forum General Session on E-Commerce in favor of a session with E-Gleiman. Remember that old adage: He who laughs last thinks slowest! If you are still thinking about that one, I'll pause a moment so you can head over to that other session.

Seriously though, I'm pleased to be here today. It occurred to me when Bill Olson, Counsel to the Association of Priority Mail Users, invited me to speak, that this was a natural for me. After all, with either one or other, and at times both of my kids away at college, grad school and now---thank heavens---working at real jobs, my wife and I have probably sent enough Priority Mail packages to qualify as APMU members.

By the way, our experience with Priority Mail has been just short of phenomenal! Packages mailed at noon on Saturday from the Colesville branch of the Silver Spring, Maryland Post Office are delivered by noon on Tuesday in Colorado and New Mexico. The kids use to call long distance to let us know the package had arrived. Now they use that feared technological competitor, e-mail, to tell us the cookies are still warm!

Our experience with Priority Mail illustrates an important point I always like to make before I subject folks to the ramblings of someone who, except when involved in rate cases or the like, is little more than a casual observer of matters postal. Given the enormity of the task---the daily volumes of mail of various sizes, weights and shapes---the potential combinations and permutations of

senders and recipients of that mail---the Postal Service, our Postal Service does an incredible job! That is not to suggest that we shouldn't ask questions or be critical when criticism is warranted.

With that, let me ramble around, offer a few comments, raise a few questions, and, perhaps, provoke some thought.

Those e-mail messages I mentioned a few moments ago arrive via my "AOL.COM" address. I hear tell that, if the Postal Service has its way, I will be able to get those messages, as well as receive and pay bills, by way of a "USPS.COM" e-mail address. I got to thinking about just what the expected outcome is for this endeavor---for putting an USPS e-mail box inside my house.

Is the Service hoping to get a piece of the electronic bill paying action?

- Will its involvement in electronic bill payment put it in the position of cannibalizing and hastening the demise of lucrative transactional mail volumes?
- Remember, each bill presented and paid by hard copy mail contributes roughly 15 cents toward the Service's overhead!
- Assuming that the Service can shed the volume variable costs associated with mail that moves from hard copy to its e-mail system, where will it get the contribution to overhead?
- Will it try to recoup the lost contribution by charging for e-mail and e-bill payment?

- If it charges 15 cents per piece, can it compete with those who offer similar services for lesser amounts and in some cases for free?

I don't mean to suggest by these questions that the Postal Service stick to the world of hard copy mail. I do, however, believe that the Service has an obligation to inform you---us---its stakeholders about the expected outcomes on any such proposal.

Turning now to Priority Mail-

Priority Mail has been fabulously successful. Not only has it been the leading volume gainer for the Postal Service in terms of percentage growth, its growth is accelerating.

Priority volume grew at just over 3 percent per year in the 70's, at about 8 percent in the 80's and more than 10 percent in the 90's. Total pieces increased from 185 million to nearly 1.3 billion.

What has been the secret elixir of Priority Mail? In the mix is: its very competitive price; its--two--to three day service commitment; and, that it is riding a tide of increasing small parcel volume and document exchange in our economy. Beyond this we must give credit to the Postal Service, which has been innovative in this highly profitable arena.

In the eighties, the Postal Service simplified rate design and introduced the two-pound envelope rate; in the 90's it mounted a seemingly effective advertising

campaign and introduced delivery confirmation. Now it's contracting out priority mail processing and transportation. Several of these moves have been an unqualified success. However, I believe the jury is still out on advertising and contracting out.

The Commission did some analysis of the advertising campaign launched in the mid-90s and found that volume increased over baseline trend, BUT the resulting increase in contribution to institutional costs did not cover the cost of the advertising. This means that, although volume increased, there may have been no overall financial benefit to the Postal Service. There are, of course, some benefits to advertising, which we did not---could---not consider in this analysis, such as ongoing benefits from an enhanced product image and the aura of a well-regarded product on the institution as a whole.

That said, I understand that a new advertising campaign featuring several so-called "e-priority" mail users is about to be unveiled. I urge the Service to forecast carefully and then measure its return on investment, so that postal advertising in general, and Priority Mail advertising in particular, is on a sound business--like footing.

Regarding outsourcing, in comparing the 1997 and 1998 CRAs (those are the annual cost and revenue analyses that the Service produces), the Commission found that Priority Mail unit processing costs declined by 3 cents, while the cost

of supplies and services increased by 24.5 cents per piece. But, 1998 was a startup period for the contract operation and that may account for that increase. We don't know how things will look in 1999 or 2000.

Regardless of the outcome of this high profile experiment, which I certainly hope is positive, the Service is to be congratulated for being innovative. Segregating priority mail from the regular mail stream and giving it special treatment in processing and transportation---but not delivery---makes intuitive sense. It says management is thinking about change---that change is possible. And, that's very important for this institution.

There have also been changes in Priority Mail which were not initiated by the Postal Service.

The Commission's records have been greatly enhanced by the contributions of John Haldi and Bill Olson. They have brought to our attention important issues in Priority Mail, and the Commission has been able to adopt a number of their proposals. In R94-1, for example, we took their suggestion to smooth the rate differentials between zones. We also split air transportation costs between distance and nondistance related costs. And, in R97-1 we changed the crossover weight between First Class and Priority to smooth the progression in rates.

I've also been told that the Commission's own R94-1 recommendation that limited the flat two pound rate to three dollars proved particularly beneficial to the Service. When speaking about the Priority Mail contract a bit earlier, I mentioned that it involved processing and transportation, but NOT delivery. This is an important distinction. How important? Perhaps we should look at something analogous in the parcel post arena.

As is the case with the Priority Mail outsourcing contract, the drop ship discounts for parcel post parcels introduced during the '90s tend to limit the Service's role in processing and transportation. This in turn elevates the importance of delivery where the USPS has economies of scope advantages. The drop ship discounts made a difference in price paid and service received by shippers. And, I suspect that these innovations have had more than a little to do with the "180" degree reversal in parcel volume---after almost forty years of decline.

When I spoke to the Parcel Shippers Association back in April, I discussed the Postal Service's comparative advantage in parcel post. Economists use the term "economies of scope" to describe the situation where two products cost less when produced jointly than if each is produced separately. The Service's parcel post advantage lies in delivery generally, but more so in residential delivery where vehicle--mounted carriers can deliver parcels along with huge volumes of letters and flats.

Delivery to commercial areas is different. Parcels tend to be larger and heavier. So, the Postal Service runs auxiliary parcel routes and scope economies are limited.

Because 95 percent of the Priority volume is less than five pounds, Priority parcels can be delivered by letter carriers on both residential and business routes. Consequently, Priority Mail enjoys even greater scope economies than parcel post.

I read recently that parcel post routes “are popping up in local post offices as a way to handle packages and Priority Mail and reduce the load for letter carriers.” Such parcel routes would impact economies of scope; they could eliminate the Postal Service’s comparative advantage in the delivery of Priority Mail and parcels; AND, most important, they may portend increased attributable costs and, therefore higher rates.

The ad hoc addition of parcel-priority routes to deal with new volumes raises the specter of suboptimization.

I hope the Postal Service will consider carefully the reintroduction and expansion of parcel routes in residential areas and not fall into a trap.

Most of you are probably aware of the small rate differences between parcel post and Priority Mail in the low weight cells. (The Commission is forced to use priority rates as ceilings when it designs parcel post rates.) To my surprise, I

recently learned first hand, using the USPS web-site rate calculator, that the price for sending my parcel via parcel post would actually be higher than sending it priority when delivery confirmation fees were included. (PM-5# 6⁵⁰+ 35¢ = 6⁸⁵ in 2/3 days vs PP-5# zone 7 6⁴⁵ + 60¢ = 7⁰⁵ 7 days).

The Postal Service's lower weight single piece parcel business seems to cry out for some reform. Eliminating lightweight parcel post in favor of Priority Mail or some other, more general realignment in the parcel area might be a solution worth considering. I would urge the Postal Service to consider the matter.

The Service may also wish to consider the desirability of a discount for Priority Mail used to drop ship publications, Standard A or other mail pieces. These priority pieces do not require delivery and appropriate discounts might be justified.

There is one last topic I would like to touch on---postal reform legislation.

One learns quickly when working on legislative matters that you can like and respect people with whom you might disagree. As those of you familiar with my testimony on HR22 know, Chairman McHugh and I do not agree on every aspect of that legislation. Nevertheless, I like him for the person that he is and respect him for the effort he has made---for getting us to move beyond the sound bite "people, prices and products" of several years ago and focused on the real substance of postal reform.

It wasn't until Congressman McHugh put something solid on the table that the debate over postal reform coalesced. It took that solid effort for groups to begin making meaningful comments on the potential impact of specific proposals--- comments such as those submitted by APMU last spring on who in the competitive products arena might bear the burden of covering postal overhead costs.

Unfortunately, in the process of addressing concerns and accommodating parties, the already complex HR22 has taken on a kind of Rorschach quality. Let me give you an example of what I am talking about.

At the Postal Forum last spring, Bill Henderson announced postal management's support for HR22. Shortly thereafter, a document with the heading "NECESSARY CORRECTIONS TO HR22" circulated. It was assumed that this document represented changes that would be made to HR22 at the request of the Postal Service. Item one on the list provided that there would be report language making clear that volume based negotiated service agreements would be allowed. Several weeks later, my friends at the National Newspaper Association announced that organization's support for HR22. Among the agreed upon changes to HR22, outlined in a letter sent by NNA to full Committee Chairman Dan Burton, was that "A volume based-discount would not be allowed to serve as the basis for a negotiated service agreement..."

Now, I could be confused about all this---it certainly would not be the first time. I also know that only in congressional legislation can one defy that law of physics about two bodies not occupying the same space. Nevertheless, it seems to me that all of us must read carefully the fine print---whenever it becomes available.

Moving from substance to process, people are always asking what I think is likely to happen with HR22. I can tell you that after years of working up on the Hill, that's what we inside the Beltway folks call it, that getting a complex bill out of subcommittee is just one very early step in a long process. I can tell you that complex, far-reaching legislation usually does not have much chance in an election year UNLESS there is widespread, popular interest and support. Next year is, of course, an election year---and a presidential election year, at that. And, I would also venture a guess that not too many folks outside of the postal community know or care about postal reform legislation. But then, I learned early-on that you can never say never when it comes to the legislative process.

Let me try a story to help put my prognosis for legislative reform in perspective---This fellow had a big old dog---always had been somewhat lethargic---but now it just didn't move at all---wouldn't eat either.

So, the fellow gathers the pooch up and takes him over to the vet.

The vet puts the dog up on the examining table and listens to its heart.

"Mister," he says, "this dog is dead."

"Can't be," says the man, "Can't you do something for him?"

The vet leaves the room and returns with a cat.

The cat circles the examining table and Meoows.

"That's it," says the vet, "He's dead!"

Again, the man protests. "Can't be; you gotta do something!"

The vet leaves the room and this time returns with a Labrador Retriever.

It circles the table and barks---twice.

"NO question, THAT dog IS dead," says the vet.

At this point the old fellow calls the vet a quack, asks for his bill and says he's going elsewhere.

The vet leaves the room, returns and presents a bill for \$650.

"\$650, for what?" asks the fellow.

“Well,” explains the vet, “I charge \$50 for an office visit, and then there’s \$300 for the cat scan and another \$300 for the lab report.”

Bottom line: I have not heard the cat meow or the dog bark, BUT I heard the lid fall off of Pandora’s box very early in the game. And, if I may borrow one from Forest Gump, always remember, legislation is---you know---like a box of chocolates, you just never know what you're gonna get!

I want to thank you for letting me visit with you this morning. Bill, if there is time, I would be happy to take a few questions.