OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

MARCH 27, 2017

SERVICE, COST, AND PRICING:
A RECAP OF THE 2016 POSTAL 360 CONFERENCE

Executive Summary

Throughout 2016, service, cost, and pricing continually surfaced as important postal challenges. On November 16, stakeholders gathered at the headquarters of the U.S. Postal Service Office of Inspector General (OIG) to discuss these issues. Representatives of the mailing community, the postal regulator, government oversight, consultants, and the U.S. Postal Service itself attended the OIG's day-long conference, dubbed Postal 360. The event consisted of four modules: service, cost, pricing, and a "Fireside Chat" panel that concluded the day.

The service module covered recent trends in delivery time and the proportion of mail whose delivery time is being measured. The percentage of mail getting measured has gone up, which commercial mailers like, but metrics reveal that service has largely failed to meet its standards, although more recently service has improved. Cost reduction efforts in response to declining mail volumes, economic recession, and network consolidation contributed to significant dips in service in 2015. The Postal Service responded in 2016 by shoring up service, though even then it fell below its established performance targets in most categories of mail. Stakeholders now want USPS to expand the amount and types of mail under measurement, out of concern that the existing metrics are not representative of the experience of all mail (e.g. some destination delivery unit mail, mail with improper barcodes, etc.). They also want rural service reported separately from city service. It was noted that more measurement and further performance improvements will incur more costs. However, the cost may ultimately be worth it: service *is* the Postal Service. All panelists concurred that having reasonably fast and, more importantly, predictable service is vital to the brand.

The cost module explored the reasons why unit costs have gone up since 2006 for all products other than Package Services. The factors responsible for product cost changes include: inflation, economies of scale, changes in the product mix, and production cost levels (e.g. technology, price of inputs, etc.). It was noted that cost changes are not smooth; therefore the Postal Service should be careful not to project existing cost lines into the future. Transparency and accuracy of cost attribution among different products also emerged as a hot-button issue during this module. One panelist argued that USPS does not attribute enough of its overall costs to parcels, which in turn allows it to keep parcel prices lower than it should. Another wondered whether the cost savings produced by customer work-sharing (such as presorting) and USPS cost-cutting initiatives (such as load-leveling) are being appropriately passed down to customers in the form of lower prices. Others countered that the current cost attribution system has been reviewed and accepted, with input from all interested parties, by the Postal Regulatory Commission (PRC) over the past 40 years.

The pricing module discussed the price regulation methodology that has been in place since the 2006 postal reform — notably the Consumer Price Index (CPI)-based price cap. This cap prevents the Postal Service from

Highlights

Service, cost, and pricing have emerged as key issues for the postal community.

On November 16, 2016, the OIG hosted a day-long conference, Postal 360, to discuss these key issues.

The event explored how service performance standards have changed over time, factors that have brought about changes in product unit costs, and possible options for future price regulation.

Ultimately, as the community considers what is appropriate for the Postal Service in the future, these issues cannot be looked at in isolation since each one impacts the others.

Stakeholders believe that unless a comprehensive reform can be agreed upon, a more significant restructuring of the Postal Service might be necessary in the near future.

raising prices faster than inflation; many stakeholders wonder if it is still appropriate given the financial difficulty the Postal Service has faced since the Great Recession. Some stakeholders further believe that the regulation did not include enough mechanisms to alter the cap in case of debilitating external factors like the recession. Participants weighed alternative price caps, as well as the option of doing away with the cap and allowing the Postal Service to set prices subject to monitoring by the regulator. Another suggestion was to allow USPS to improve its financial position through other means, with no change to the price cap — for example, by investing its employee retirement fund in something other than Treasury bills. These are all options that Congress or the PRC must weigh. Ultimately, regardless of what the PRC decides regarding the current price cap, it is possible that the legality of any change could end up before the D.C. Circuit Court.

In the Fireside Chat, panelists noted the importance of each of these topics but also agreed that they cannot be solved in isolation. There are too many leaks to plug and not enough money to plug them with. Comprehensive reform is necessary. The legislation that has been before Congress would be a good start, but more will need to be done. If this bill does not pass, warned the panelists, then more drastic measures may be considered. While awaiting direction from Congress and the PRC, the Postal Service can still take some action. One suggestion was for USPS to address more problems at a local level or with customized solutions, rather than creating national, standardized solutions.

The views summarized in this paper reflect the discussion that transpired during the event and do not necessarily reflect the views of the Office of Inspector General.

OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

Promoting Integrity and Accountability in America's Postal System

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Introduction

Service, cost, and pricing are all issues of major consequence to the U.S. Postal Service and its customers. Customers are pleased by fast, reliable service and turned off by slow or erratic service. They are pleased by low prices and turned off by high prices. When costs go up or down, service and price inevitably feel the effects, so customers weigh in on cost issues too.

Not only are service, cost, and pricing fundamental, they should always be considered together because of the way they interact with one another. They have been described as three legs of the same stool. Destabilize any of them and the whole stool topples over. The Postal Service must be ever mindful that it is simultaneously providing quality service, controlling its costs, and keeping its prices reasonable.

> ***"One of the objectives specified in Section 3622 (of PAEA) is that the rate-making systems should ensure that we can provide high-quality service. …Clearly being in a state of constant financial turmoil imperils the achievement of that objective."***
>
> **Keith Weidner, Chief Counsel, Legal Policy and Legislative Advice, USPS**

How to achieve these ends is a matter of much debate — as is the matter of whether they can be achieved at all under the current constraints faced by the Postal Service. The U.S. Postal Service Office of Inspector General (OIG), in drafting the agenda for its all-day event, sought to ensure that many viewpoints were heard. The conference was named Postal 360 for the way it encompassed every angle. Mailers, regulators, consultants, unions, observers, and of course the Postal Service itself were all represented at this event, held November 16 at OIG headquarters in Arlington, VA. An agenda listing the speakers can be found in Appendix A.

Each of the three topics — service, cost, and pricing — received its own module. The service module examined how the Postal Service's performance standards have changed over time and what changes mailers might like to see in the future. The cost module explored the reasons *how* and *why* product unit costs have changed since 2006 and whether costs are being properly allocated among products. The pricing module explored alternatives to the current regulatory pricing regime. The day wrapped up with a Fireside Chat where panelists offered overarching thoughts about the issues they had heard throughout the event.

This paper is intended to summarize the key points made during the conference for those who were unable to be there in person. The authors relied on audio recordings of the event and allowed all participants to review the final text for factual accuracy. Where necessary in the paper, opinions are attributed directly to a panelist. The views presented herein are not necessarily those of the Office of Inspector General.

Service Module

Service is fundamental to the Postal Service. It is part of the Postal Service's name and reason for existence. In a 2015 examination of the postal brand, the OIG found that a key component of the brand was "reliable, dependable, and prompt services and products."[1] In other words, the postal brand is built on an expectation of fast and predictable delivery. With so many alternative platforms for communication and logistics, customers' tolerance for slow or unpredictable delivery is lower than ever. This section explores how service standards have developed over time as well as whether those standards, and service performance, meet customer expectations.

PAEA Gave Us Service Standards

Prior to the Postal Accountability and Enhancement Act of 2006 (PAEA), no service standards were mandated, and the Postal Service generally did not release service performance information for mail other than First-Class Mail. The Postal Service published a compact disc that contained voluntary service targets between pairs of 3-digit ZIP codes and would be delivered to mailers upon request. This was viewed by mailers as complex (especially given the thousands of pairs of 3-digit ZIP codes) and essentially not useful because actual delivery information was not available. Mailers could do their own tracking and bring the results to the Postal Service,

1 U.S. Postal Service Office of Inspector General (OIG), *The Value of the U.S. Postal Service Brand*, Report No. RARC-WP-15-005, January 28, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-005_0.pdf.

but without a common set of data for the two sides to reference, nor a set of standards to adhere to, disputes were seldom resolved.

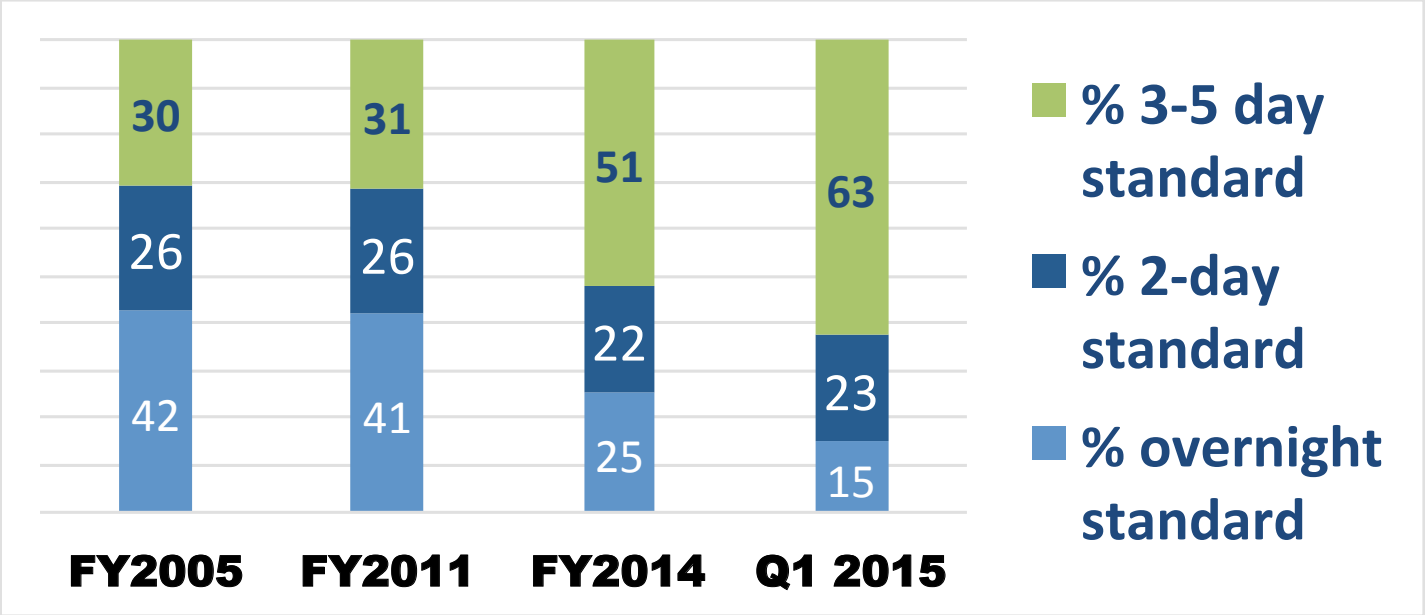
PAEA mandated service measurement across all market-dominant postal products for the first time. It also required the Postal Service to establish a set of service standards reflecting what mailers said they needed and what the Postal Service said it could provide. Since then, USPS has regularly reported to the Postal Regulatory Commission (PRC) on whether it is meeting those standards in each class of mail. When PAEA was passed in 2006, only 15 percent of market-dominant mail was being measured for service performance.[2] However, the Government Accountability Office (GAO), which has also been monitoring service, found in 2015 that USPS had increased the percentage of market-dominant mail being measured to 55 percent. Some of this can be attributed to the Intelligent Mail barcode that makes mail easier to scan and track.

Furthermore, service standards have not remained constant — they have changed over time and as part of the Postal Service's own cost-cutting measures in response to declining mail volumes. In fiscal year (FY) 2011, 41 percent of all First-Class Mail had an overnight service standard, but by the first quarter of FY 2015, only 15 percent of First-Class Mail fell into the overnight service standard category, partly because during that time period USPS eliminated overnight service standards for Single-Piece First-Class Mail (see Figure 1). Additionally, in 2014 the Postal Service began "load leveling" some of its Standard Mail. Under this change, Standard Mail entered on Fridays or Saturdays was allowed one additional day to meet its service standard, in order to limit the volume of mail that had to be delivered on Mondays, which is the highest-volume day of the week.[3] Mailers report difficulty in achieving desired Monday in-home dates as a result of this change.[4]

Performance Has Not Always Met Standards

Service standards were lowered across several mail types in 2015, yet even then, the standards were not met. Among 10 types of mail measured each year between fiscal years (FY) 2009-2015, the standard for any individual type has been met only 11 times — a 16 percent success rate.[5] Compounding the problem was the Great Recession of 2008, whose devastating effect on mail volume will be discussed in the Pricing Module section of this paper. As volume plummeted, the Postal Service reacted with a consolidation of its national facility network.

Figure 1: First-Class Mail Volume by Service Standard



Source: USPS Service Performance & Measurement, Kathy Siviter, presentation at Postal 360. Fiscal year (FY) 2005 & FY 2014 figures reported by USPS in "USPS Delivery Standards and Statistics Fact Sheet" published in March 2015. FY 2011 figures reported by USPS in September 2011 *Federal Register* notice with proposed service changes. 2015 figures reported by USPS at MTAC First-Class Mail Focus Group Meeting.

2 Market-dominant products consist mostly of letters and flats. The Postal Service has a legal monopoly on these products.

3 U.S. Postal Service, "Balancing the Load: Load leveling to more evenly spread Standard Mail delivery," https://about.usps.com/news/electronic-press-kits/usps-sets-the-record-straight/load-leveling.htm.

4 "USPS Service Performance and Measurement Draw Attention," *Mailers Hub News*, Feb. 17, 2017.

5 Postal Regulatory Commission, *Annual Compliance Determination Report: Fiscal Year 2015*, March 28, 2016, http://www.prc.gov/docs/95/95462/Final_2015_ACD.pdf.

The Postal Service's Keith Weidner told the Postal 360 audience that the pace of the second phase of network consolidation, which began in January 2015, had service impacts that were greater than anticipated and that perhaps could have been mitigated if the Postal Service had the luxury to move slowly. The Postal Service's deteriorating financial condition dictated that rationalization was necessary in light of the Postal Service's excess capacity. Postmaster General Megan Brennan vowed to diagnose and correct the ensuing service problems during a Senate hearing in January 2016. The FY 2016 results show that the Postal Service has followed through. FY 2016 performance has improved over FY 2015 in nearly all of the main categories of mail (though it still failed to meet the targets in most categories).

There is still a significant portion of the mail that is not being measured, such as drop-shipped mail bundles (which are entered into the postal system close to delivery destination) or mail that cannot be processed on automated equipment. GAO reported in 2015 that service performance data for 45 percent of market-dominant mail were not included in final service performance results, so there is no way to know whether the mail that is measured is representative of all mail. Mailers fear that it is not. The Postal Service has since raised the amount of mail under measurement to about two-thirds, according to GAO's Lori Rectanus.

Mailers would also like more insight into mail that fails to meet its standard; right now, it is not known if mail that misses its delivery target misses it by one day, several days, or more — the so-called "tail of the mail."[6]

Some Improvement, but Inconsistency Remains

Even for mail that is measured, mailers are concerned that the data are not always representative of service experiences. Some mailers say that their internal service metrics do not match the quarterly performance scores published by the Postal Service. This is not necessarily a result of bad data on either side, but rather a lack of consistency in actual service experiences that may have mailers in one area of the country receiving a different level of service than those in another. Inconsistency creates one of any business' biggest fears — unpredictability. Business mailers can accommodate consistently slow delivery better than they can accommodate delivery that sometimes beats the standard and sometimes falls days behind.

> ***"Inconsistent, unpredictable service undermines the value of mail."***
>
> **Kathy Siviter, President, Postal Consulting Services**

Service performance can vary between days of the week and times of the year. But the inconsistency getting the most attention is between urban and rural ZIP codes. Rural customers and those who mail to them are increasingly vocal about what they perceive to be inferior service. While a GAO study on the best and worst performing districts did not find that urban districts consistently outperformed rural ones, Congress has urged the Postal Service to monitor rural performance separately in the future.

Service *Is* the Postal Service

All this negative attention on the Postal Service's inability to meet service standards harms the postal brand.[7] It makes the channel less valuable, which hurts mailers. So the mailing industry must walk a fine line that pushes USPS to improve service without triggering a chain reaction of criticism that cripples the mail channel. Advertisers like the affordability of mail (and the fact that it may be "stickier" than digital ads) but, with online options allowing them to target specific customers, they are less tolerant than ever of shaky service.[8] There is also a critique that the Postal Service is neglecting its service responsibilities for mail because it is more focused on parcels. The Postal Service strongly denies these claims, pointing to its efforts to address mail service performance over the past year.

Customers are asking for more mail, and more types of mail, to be put into measurement and for more data to be collected. They want to ensure the measurement metrics are representative of all types of mail. They want that data funneled into publicly-available apps that reveal performance trends by mail type, day of the week, ZIP code, and more. (It was noted that USPS and the PRC have already offered additional data on their respective websites.) They want studies on how service changes

6 The Postal Service does publish a report that includes some of this information. See for example, USPS "Quarterly Performance for Standard Mail Service Variance," Q4 FY 2016, https://about.usps.com/what-we-are-doing/service-performance/fy2016-q4-standard-mail-service-variance.pdf. However, the report was not mentioned during the module so it is outside the scope of this recap to comment on the degree to which it addresses concerns about tail of the mail information.

7 OIG, *The Value of the U.S. Postal Service Brand*.

8 OIG research found that people were more likely to remember advertising content from mail pieces than from digital sources. OIG, *Enhancing the Value of Mail: The Human Response*, Report No. RARC-WP-15-012, June 15, 2015, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-15-012.pdf.

affect volume over the long term. They want data on rural performance to be separated out (which the Postal Service is currently working on, with the PRC). All of this costs money, as the mailing community readily admits.

More measurement data is always better in theory, but what if the cost of gathering new data requires sacrifices elsewhere? It may be impossible for the Postal Service to provide a high level of measurement or service if it is constantly in a state of financial turmoil. For as long as that remains the case, mailers, regulators, and the Postal Service must debate these trade-offs together.

One proposal was to offer a sort of "service-plus" option to customers in which they would be alerted when a piece of mail was going to fail to meet its service standard. They would then have the option of paying an extra fee to rush that piece so that it would arrive on time. Rather than having cost/service tradeoffs codified in regulation, mailers could make decisions on a case-by-case basis. (Whether such an option is feasible is uncertain.)

> ***"Even if the Postal Service can get more money, is that going to lead to better service or is that just going to allow them to keep their head above water?"***
>
> **Lori Rectanus, Director of Physical Infrastructure, GAO**

Cost Module

The cost module began with economics professor Michael Bradley, of The George Washington University, presenting research he has been undertaking for a separate OIG white paper. He explained that even as service has declined and the Postal Service has implemented network rationalization to cut costs, the cost to produce a unit of most products — packages being a notable exception — has risen over the last 10 years.[9] This section explores the reasons why product costs have changed over time and the issues that stakeholders have with the transparency of the cost attribution methodology.

Several Factors Have Changed Product Costs over Time

Between 2006 and 2015, unit costs for First-Class Mail, Standard Mail, and Periodicals went up at least 13 percent in nominal dollars, as shown in Figure 2. Periodicals rose by double that amount — 26 percent. On the bright side, the unit cost for Package Services dropped.[10]

In his analysis, Professor Bradley looks at how several factors contributed to cost changes between 2006 and 2015; these factors can be grouped as follows:

1. *Inflation (or deflation)* — The change in all costs across an economy. A common measure for this inflation is the Consumer Price Index (CPI), which increased 18 percent between 2006 and 2015. This tracks closely with the growth in product unit costs, except for Package Services.

2. *Changes in the sub-product mix* — Each product category contains subproducts, some of which are more costly than others. A shift in their proportions therefore affects the average unit cost for the product category. For example, the growth of drop-shipped packages, which are cheaper to process and deliver, has driven down Package Services unit costs.

Figure 2: Overall Change in Product Unit Costs 2006-2015

	FY 2006 Unit Cost	FY 2015 Unit Cost	Change	% Change
First Class	$0.193	$0.218	$0.025	13.0%
Standard	$0.120	$0.138	$0.018	14.8%
Periodicals	$0.285	$0.360	$0.075	26.3%

Source: Measuring the Sources of Change in the Postal Service's Product Costs, Michael Bradley, presentation at Postal 360.

9 The unit cost of each product is the cost to process and deliver a single unit — one piece of Standard Mail, one periodical, etc. If volume drops, it is possible for total costs to decrease while unit costs increase.

10 OIG, *Examining Changes in Postal Product Costs*, Report No. RARC-WP-17-005, March13, 2017, https://www.uspsoig.gov/document/examining-changes-postal-product-costs.

3. *Economies of scale* — An increase in volume pushes the marginal cost of each unit down. Conversely, a decrease in volume pushes marginal costs up. With less volume in the system, each piece has a tendency to incur more individual cost. The results reflect this; market-dominant products saw costs rise as a result of declines in both individual product volume and overall volume.

4. *Production cost levels* — This catch-all category takes into account changes in: technology and productivity, product quality (e.g. more expensive packaging), product characteristics (e.g. heavier packages), and the price of inputs (e.g. wages). These factors are difficult to tease out individually, so their effects were calculated as all cost effects left over after the other factors were accounted for. Production costs fell for all products except Periodicals.

The Past Does Not Define the Future

Professor Bradley cautioned that one should not expect future costs to be influenced by these factors in the same way they have been previously. For example, Package Services benefit from economies of scale that push costs down as package volume rises.[11] In the future, however, package volume might rise so much that existing processing facilities and delivery vehicles will no longer be able to handle the load. This would force the Postal Service to buy bigger delivery vehicles or open more sorting facilities, which would drive costs up again.

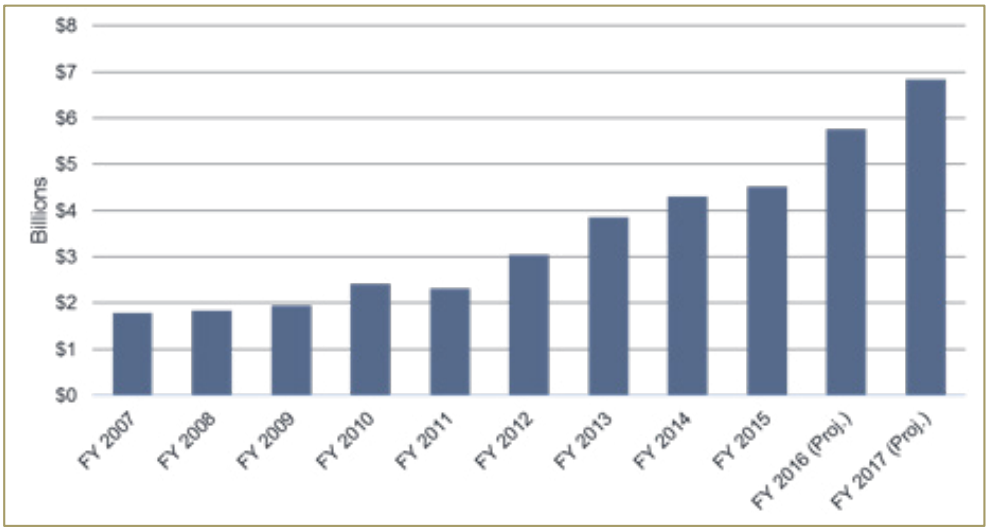
Additionally, the benefits of future production cost reductions may not be as great as those that have already happened. One can assume that the Postal Service chose to make the low-hanging improvements first, meaning any future improvements will produce less benefit. Jim Holland of the National Association of Letter Carriers provided an example: in 2009, USPS began a series of carrier route adjustments that sliced 10,000 routes out of the national delivery network. They had the effect of adding almost 100 delivery points to each route over time. Labor costs shrunk accordingly. However, such drastic consolidation may be difficult to reproduce.

Cost Attribution

It emerged during the panel discussion that some stakeholders take issue with the way postal costs are calculated and attributed to each product. Jessica Lowrance of the Association for Postal Commerce said that the workshare discounts that mailers get from performing presort and drop-shipping are not equal to the cost savings that those processes provide to the Postal Service. There are questions about the cost of rural vs. urban delivery as well.

Another dispute was about whether the cost of competitive products is being properly separated out from total costs. Keith Kellison of UPS argued that the Postal Service is attributing far too small a share of its total costs to competitive products, which results in prices for Package Services that are unfairly low and hurts UPS' ability to compete. The cost of processing and delivering a package, he said, is at least an order of magnitude higher than processing and delivering a letter or flat. However, defenders of the Postal Service's numbers argue that the cost system accounts for this. The public filings show that competitive products not only cover their costs, said Larry Buc of SLS Consulting, but have been profitable every year since PAEA was enacted, culminating in a projected $7 billion in contribution in FY 2017 (Figure 3). The Postal Service's competitors, he said, have been bringing this issue before regulators for 40 years with no success.

Figure 3: Competitive Product Contribution FY 2007-FY 2017 (Projected)



Source: Competitive Product Contribution FY 2007 to FY 2017, Larry Buc, presentation at Postal 360.

11 Economies of scale are the effects whereby the marginal cost of producing each unit of a product is cheaper than that of the previous unit. In other words, average costs shrink as volume grows.

Transparency Is Vital to the Mailing Industry

Just like with service data, postal stakeholders would like to see more granular cost data to ensure products are priced fairly. This data would allow them to more carefully pick apart institutional vs. product costs, market-dominant vs. competitive costs, or fixed vs. variable costs. Defenders of the Postal Service contend that much of the data being asked for are available already, and that the opponents of the cost system either do not know where to find the data or simply do not agree with the conclusions that have been drawn from it.

Stakeholders have also asked the Postal Service to be more transparent about the actual cost savings produced by its big initiatives — new vehicle purchases, load leveling, Intelligent Mail barcode, etc. — rather than just showing projected cost savings. Mailers are concerned that cost savings produced by these initiatives are not being passed down to customers in the form of lower rates.

Expect this debate to continue. As long as interested parties deem prices to be too high or low for their own needs, they will keep arguing with the Postal Service about the cost numbers that undergird those prices. In the end it will be the PRC making final determinations on the allocation of costs.

Pricing Module

A private company that needed to boost its level of service or compensate for rising costs would probably raise prices. The Postal Service is not a private company, of course, even though it is often expected to act like one. It cannot just raise the price of postage to balance its books, due to the price cap instituted by the 2006 PAEA law.

Postal Reform in 2006 Introduced New Price Regulation

Prior to PAEA, from 1971 to 2006, prices were set according to a cost-of-service regime. Under this methodology, prices were set to cover product costs and included a markup to cover, among other things, institutional costs. There was not a set time period to make price changes, as it depended on when the Postal Service needed money, but rates changed every 3 years on average. This price-setting process was lengthy. Customers complained of large, unpredictable price increases, protesting that the Postal Service had no incentive to cut costs or increase efficiency since prices could always be nudged up to cover costs.

PAEA changed all that by implementing a price cap that would only rise at the pace of CPI. At the time, it looked like the move to incentive regulation would be a win-win: mailers would get their smaller and predictable price increases, and the Postal Service could still earn enough revenue while being incentivized to control costs. But the ink had barely dried when the Great Recession hit. The tenuous balance achieved by the price cap shifted suddenly.

The Great Recession Changed Everything, Impacting the Success of That Regulation

The type of pricing regulation set forth in PAEA is most effective in a volume-increasing environment. But beginning in 2008, the Postal Service started seeing a steep decline in mail volume, particularly in First-Class Mail, which is its greatest contributor to the coverage of institutional costs.

> ***"It was a hat-trick of bad: declining volume, increasing delivery points, and a change in the mix where the higher contribution products were declining faster than the lower contribution products. That spelled doom for this cap."***
>
> **Mark Meitzen, Vice President, Christensen Associates**

Across other regulated industries, most price caps are re-evaluated every 4 to 5 years to make sure they are functioning as intended. The PAEA-imposed cap had a 10-year life span. Caps in other industries are often designed with off-ramps in case a serious change of circumstances should occur between evaluation periods; the PAEA cap did not have such a safety valve. Revenue suffered when First-Class Mail volume — which is down 36 percent since 2006 — started to fall rapidly at the onset of the Great Recession. CPI did not rise fast enough to compensate for that loss. The only clause for dealing with such a drastic loss of revenue was the exigency provision (whereby the PRC could adjust rates "due to either extraordinary or exceptional circumstances"). The PRC implemented the exigency in 2014 but removed it in April 2016, against the Postal Service's wishes.

All Is Not Lost: There Are Alternatives

PAEA did not foresee a future that was drastically different from the status quo in 2006. Mail volume had reached its highest level ever that year. It has dropped every year since, thanks to digital diversion and the Great Recession. Knowing what we know now, the existing CPI cap may not function properly in a declining-volume environment. That does not mean that the affordability, predictability, and stability in pricing that the cap tried to achieve are not still achievable.

Reform the Price Cap

If price regulation is to be reformed into something that allows greater flexibility for the Postal Service to improve its financial position, one option would be to choose an alternative type of price cap. A 2013 OIG study on the topic suggests two alternatives (Figure 4):

- A revenue-per-delivery-point (RDP) cap starts with a CPI-based cap, then adjusts it to ensure a certain level of revenue per delivery point. USPS would fare better financially during periods of falling volume and worse during periods of rising volume. The problem with this cap lies in the perverse incentive it creates for the Postal Service to try to keep volume low.[12]

- A hybrid cap would allow price increases above CPI as volume decreases and delivery points rise, but adjusts the increase to take into consideration that not all costs vary with volume.

Other possible options for price reform, either in addition to changing the type of cap or as a standalone measure, include:

- changing the definition of what products are subject to the price cap;

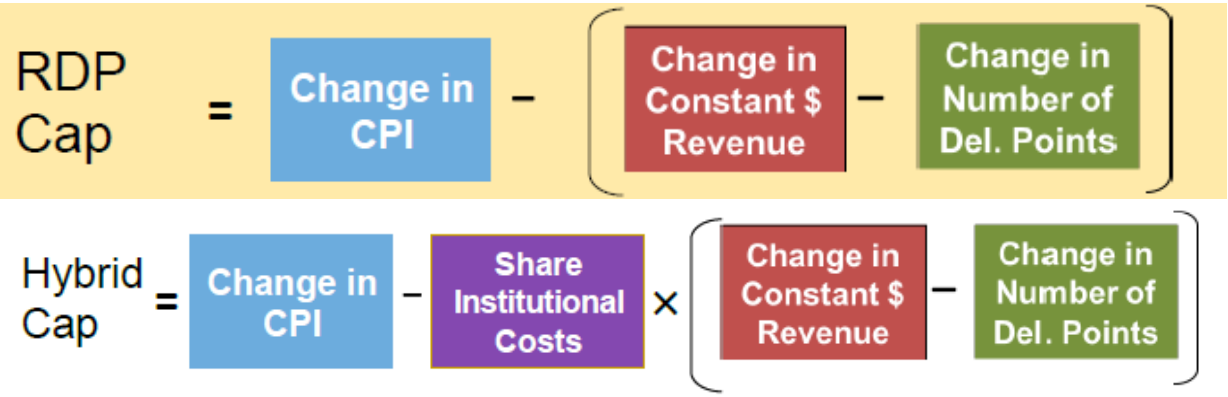
- giving the PRC the freedom to remove the price cap and have the Postal Service set the prices where it sees fit, subject to PRC supervision and monitoring.

There are plenty of options, although any changes to the price regulation might add unpredictability and complexity. The Postal Service's financial future might be preserved at the expense of the pricing predictability that mailers so desire.

Recognize That Price Increases Are Not the Only Way

Some participants did express the sentiment that price increases are not the only way to generate assets or lower liabilities. If the Postal Service were allowed to engage in other fundraising activities it would not necessarily need to resort to price increases. This would make price increases and price regulation less critical of a discussion. An option suggested by one panelist, Larry Buc, would be to place the $338 billion that currently sits in the employee retirement fund into an investment instrument that gets a higher rate of return.[13] By law the Postal Service can only invest in Treasury bills, which earned less than a 3-percent return in 2016. If it invested in something that earned closer to a market rate of return — say 6 percent — that would translate to almost $11 billion in additional funds every year. With an extra $11 billion around, the Postal Service would be under much less pressure to raise prices.

Figure 4: Two Alternative Price Caps and Their Components



Source: Postal Price Regulation, Jennifer Bradley, presentation at Postal 360.

12 OIG, *Revisiting the CPI-Only Price Cap Formula*, Report No. RARC-WP-13-007, April 12, 2013, https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-13-007_0.pdf.

13 According to the Postal Service's most recent financial filing, they currently have $51.862 billion in their retiree health benefit fund, $174.4 billion in their CSRS fund (projected), and 112.1 billion in their FERS fund (projected) for a total of $338.362 billion in 2016. See U.S. Postal Service, *2016 Report on Form 10-K*, http://about.usps.com/who-we-are/financials/10k-reports/fy2016.pdf.

Who Decides the Course for the Future?

The current price cap is coming up for review by the PRC under the 10-year review mandated by PAEA. The cap's detractors want the PRC to take the opportunity to declare the cap untenable. If the PRC attempts to eliminate or even change the cap, there is a possibility of a petition for review to the U.S. Court of Appeals for the D.C. Circuit for a final decision. The Court could rule that the PRC's decision to replace the cap was arbitrary — regardless of what that means for the Postal Service's future. It was noted during the discussion, however, that the D.C. Circuit Court routinely defers to regulators' judgment. Until a decision is made, the current climate of uncertainty and worry over the Postal Service's financial problems will continue.

"This discussion is all about how much we need to raise prices to generate sufficient revenues to allow the Postal Service to continue to operate in a way that, in some respects, really ignores the gravity of the problems it's facing...The real question is how much weight can commercial mailers bear to sustain the system on the market-dominant side. That's really where the pressure will be felt."

Michael Scanlon, Partner, K&L Gates

Fireside Chat

For all of the haggling over rural service quality, or what costs should be allocated to parcels, or whether a hybrid price cap is a good model, those debates may not get to the root of the Postal Service's problems. That much was revealed by the reactions of the panelists at the Fireside Chat session. They were offered an opportunity to comment on any aspect of service, cost, or pricing that they had heard throughout the day. It was telling that they chose not to tackle any of them, but instead focused on the fundamental public policy questions of what do you want your government sponsored Postal Service to do, and how are you going to pay for it.

Service, Cost, and Pricing Are All Interconnected

There was resounding agreement that the postal community needs to examine service, cost, and pricing collectively. Service, especially the universal service obligation, comes at a cost. The money to pay for that cost has to come from somewhere, which is where pricing enters the picture. The Postal Service would be better able to address these issues one by one, as needed, if it were on firmer financial footing as an organization. But given its present state, it may be the case that a "fix" of either service, cost, or pricing will not be enough to stabilize the Postal Service in the long run.

A more holistic solution involving major structural changes would then have to be put on the table. On one extreme end is privatization. On the other extreme is allowing the taxpayers to keep it afloat by giving it congressional appropriations. The Postal 360 audience was reminded that the Postal Service was not, at its creation, intended to be a money-making endeavor, but rather a universal service provider charged with binding the nation together and keeping the public well-informed. Whether that function is still applicable is in the eye of the beholder. Many would argue that the postal network has transformed from a communications channel to a transactional channel, and is therefore less entitled to a status as a public good. Other holistic solutions between the two extremes of privatization and appropriations are possible as well, though they were not brought up during this discussion.

"When we look at these issues in isolation, it becomes very easy to miss the big picture.

Kevin Calamoneri, Deputy General Counsel, USPS

> ***"Postal politics is a lot easier in a time of plenty. Those days are gone now."***
>
> **Kevin Kosar, Governance Project Director, R Street Institute**

Legislation Is Needed Now… but That Is Not Enough

Some say that the responsibility for answering these foundational questions belongs to Congress, and that therefore the postal community will take its direction from future legislation. However, these are extremely complex issues that are made more so by the current time of crisis. It will take a long time (and a certain amount of political will) for lawmakers to fully understand the complexities. Balancing all of the stakeholders' concerns makes this task very difficult to get right.

There was discussion as to whether the postal reform legislation that was before the House in 2016 "gets it right." The bill is not a visionary one, according to Kevin Kosar of the R Street Institute; it does not provide the structural reform needed to ensure solvency for decades to come. Rather, it offers breathing room. It makes a number of trade-offs and involves the minimum acceptable sacrifices required to patch up the Postal Service's immediate problems. No one stakeholder seems to be fully satisfied by the bill, but everyone seems to regard it as more palatable than the drastic proposals that might come out of Congress should no compromise be reached.

Think Big, but Start Small

While the postal community awaits reform, the Postal Service still has a responsibility to try to improve service, decrease costs, and raise revenue under the current framework. Paradoxically, this may mean considering small-scale solutions. USPS tends to think on a huge scale — a scale that matches its network. According to Tonda Rush of the National Newspaper Association, it too often takes a centralized approach to fixing problems that would be better addressed at a local level. It also looks to standardize solutions nationally when some situations would be better resolved by a postmaster or district supervisor. If the Postal Service started thinking like a small business with solutions that are tailored to specific problems, those solutions could make a collective financial impact on the organization.

> ***"We need a bill, or we won't like what we get next year."***
>
> **Jeanette Dwyer, President, National Rural Letter Carriers' Association**

Conclusion

The Postal Service, OIG, and various stakeholders spend a significant amount of time researching service, cost, and pricing. The insights that came out of Postal 360 provided new food for thought and new windows into how postal stakeholders are thinking about these topics. It is important that stakeholders continue to engage with each other in order to overcome the big challenges that the Postal Service is facing today. To the extent that Postal 360 could provide a forum for that, it has served its purpose.

The tradeoffs between service, cost, and pricing are contentious issues, not least because they are simultaneously so complex and so important. Passage of a postal reform bill by Congress would quell some of the urgency, but the debates will rage on long after. For now, most stakeholders seem committed to finding compromise positions on what level of service is possible, how costs can be controlled, and how prices can be set to keep the Postal Service viable. It is in no one's interest to see the three-legged stool lose its balance.

Management's Comments

Management believes the OIG should not have produced a written summary of the Postal 360 Conference because any summary paper will be tainted by the perspective of the authors, and therefore risks mischaracterizing the speakers' words or emphasizing certain points over others. They also objected to the use of subheadings and quotes as potentially inflammatory if taken out of context.

Evaluation of Management's Comments

The OIG thanks the Postal Service for its comments. The purpose of this recap is to share important conversations that occurred at the Postal 360 Conference with people who were not able to attend, as well as provide a written record for attendees. This report is based on meticulous notes taken during the event as well as audio recordings of each module. Additional background information was added in some places to help readers understand the context of the topics that were discussed. A draft paper was circulated among all 17 speakers and panelists for review; all feedback, including from the Postal Service, was carefully considered by the OIG and incorporated into the final draft where appropriate. Therefore, we believe the recap is accurate and fair. However, we respect the Postal Service's perspective. We thank them for lending a crucial voice to the Postal 360 event.

Appendix A: Postal 360 Agenda

SCHEDULE OF EVENTS

CHECK-IN & CONTINENTAL BREAKFAST | *8:00-9:00 AM*

INTRODUCTION & WELCOME ADDRESS
9:00 - 9:15 AM

Bruce Marsh, Director of Government Relations, *U.S. Postal Service Office of Inspector General*
Tammy Whitcomb, Acting Inspector General, *U.S. Postal Service Office of Inspector General*

MODULE 1 — WHAT TO DO ABOUT SERVICE?
9:15 - 9:30 AM

Moderator - John Pickett
Senior Economist, *U.S. Postal Service Office of Inspector General*

Key Service Performance Issues - Laraine Balk Hope
Senior Economist, *U.S. Postal Service Office of Inspector General*

Panel Discussion / Q&A
9:30 - 10:45 AM

Kathy Siviter
President, *Postal Consulting Services*

Lori Rectanus
Director, Physical Infrastructure, *U.S. GAO*

Curtis Kidd
Senior Analyst, Service Performance Team Leader, *Postal Regulatory Commission*

Keith Weidner
Chief Counsel, Legal Policy and Legislative Advice, *U.S. Postal Service*

BREAK | *10:45-11:00 AM*

MODULE 2 — HOW HAVE COSTS CHANGED OVER TIME?
11:00 - 11:15 AM

Moderator - Jennifer Bradley
Senior Economist, *U.S. Postal Service Office of Inspector General*

Considerations on Costing - Professor Michael Bradley
George Washington University Department of Economics

Panel Discussion / Q&A
11:15 AM - 12:30 PM

Jessica Lowrance
President Elect, *Association for Postal Commerce*

Jim Holland
Research Director, *Natn'l Assoc. of Letter Carriers*

Keith Kellison
Sr. Vice President, Global Public Affairs, *UPS*

Sharon Owens
Vice President, Pricing & Costing, *U.S. Postal Service*

LUNCH | *12:30 - 1:30 PM*

MODULE 3 — WHAT OPTIONS FOR POSTAL PRICING?
1:30 - 1:45 PM

Moderator - Jeff Colvin
Director of Finance and Economics, *U.S. Postal Service Office of Inspector General*

Research on Postal Pricing - Jennifer Bradley
Senior Economist, *U.S. Postal Service Office of Inspector General*

Panel Discussion / Q&A
1:45 - 3:00 PM

Larry Buc
Owner, *SLS Consulting Inc.*

Michael Scanlon
Partner, *K&L Gates LLP*

Mark Meitzen
Vice President, *Christensen Associates*

Andrew German
Managing Counsel for Legal Strategy, *U.S. Postal Service*

BREAK | *3:00 - 3:20 PM*

FIRESIDE CHAT & PANEL DISCUSSION
3:20 - 4:30 PM

Moderator - Tammy Whitcomb
Acting Inspector General, *U.S. Postal Service Office of Inspector General*

Kevin Calamoneri
Deputy General Counsel, *U.S. Postal Service*

Jeanette Dwyer
President, *National Rural Letter Carriers' Association*

John Kane
Sr. Advisor, Committee on Homeland Security and Gov. Affairs, *U.S. Senate*

Tonda Rush
Director, Public Policy, *National Newspaper Association*

Kevin Kosar
Sr. Fellow & Governance Proj. Dir., *R Street Institute*

Jeffrey Post
Sr. Advisor, Deputy Staff Director, *House Oversight and Government Reform Committee*

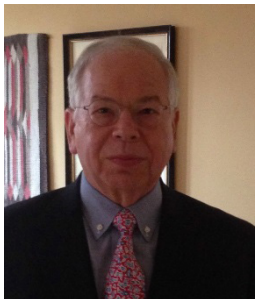
CONCLUDING REMARKS
4:30 - 4:45 PM

Bruce Marsh
Director of Government Relations, *U.S. Postal Service Office of Inspector General*

Appendix B: Speaker Biographies

Michael Bradley

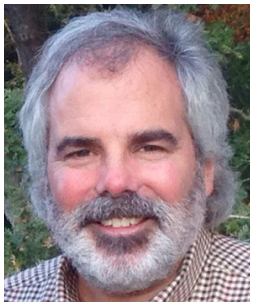
Michael D. Bradley is Professor and Deputy Chair in the Department of Economics at The George Washington University where he has received awards for both his scholarship and his teaching. An internationally recognized expert on postal economics, Professor Bradley has published sixty academic articles and supervised research on over seventy doctoral dissertations. In addition to his academic work, Professor Bradley has provided economic advice to postal administrations in Europe, Asia, and North America.



Larry Buc

Lawrence G. Buc is a co-founder and President of SLS Consulting, Inc., a Washington DC firm specializing in postal pricing, costing, finances, and environmental issues. Prior to working for SLS, Mr. Buc has experience working for the United States Postal Service, the Postal Rate Commission and the Environmental Protection Agency. He has his Bachelors in Mathematics and Economics from Brown University and a Masters in Economics from The George Washington University.

Kevin Calamoneri



Kevin Calamoneri has served in the General Counsel's Office of USPS for 18 years. He is currently the Deputy General Counsel for Headquarters and oversees the Postal Service's regulatory practice, particularly as it pertains to pricing and products. Previously he was Managing Counsel of Corporate and Postal Business Law. Mr. Calamoneri has also worked in the private sector at a number of large corporate law firms and served as a prosecutor in the State of New Jersey.

Jeanette Dwyer

Jeanette Dwyer is, since 2011, President of the National Rural Letter Carriers' Association. She has also served the association as both Vice President and Executive Committeeman. Jeanette began her postal career as a carrier substitute before becoming a regular rural carrier, a position she held for 33 years, during which time she began her work both as a Local Steward and State Steward.

Andrew German

R. Andrew German is the Managing Counsel for Legal Strategy in the Postal Service's Law Department. In that position he supervises the Postal Service's commercial and appellate litigation, and advises on legislative and policy matters. Previously, he was Managing Counsel for Pricing and Product Development.

Jim Holland

Jim Holland is the Research Director at the National Association of Letter Carriers, AFL-CIO, a labor union that represents over 210,000 City Letter Carriers who work for the U.S. Postal Service. He joined the NALC in 2013 and heads the NALC's Research Department. The Research Department provides research and analytical support for the NALC President's office, including collective bargaining support, financial analysis, and industry research and analysis. Prior to joining the NALC, Jim worked as a research analyst for industrial labor unions and as a financial analyst.

Keith Kellison

Keith Kellison is the Senior Vice President of Global Public Affairs at UPS, where he represents the company on Capitol Hill, with an emphasis on Postal, Alternative Fuel Vehicles, and Energy/Sustainability. In early 1998, Kellison entered into the mail industry as the Chief Financial Officer and General Counsel for Regional Mail Xpress (RMX), which was later acquired by UPS. He has held various positions within the company, eventually being transferred to UPS' Global Strategy Group, in charge of various projects with an emphasis on UPS' Mail Strategy and UPS Mail Innovations. In 2009, Kellison assisted in establishing various programs with the U.S. Postal Service, including SurePost and Retail, and became the primary UPS Small Package liaison with the Postal Service.

Curtis Kidd Telemaque

Curtis joined the PRC in 2008. He worked on several service-related Commission projects before becoming Senior Analyst and Service Performance Team Leader. As Team Leader he is responsible for guiding research and analysis on all service-related issues. Outside of the postal industry, Curtis spent more than 10 years in the financial services industry holding such positions as Senior Institutional Equity Trader, General Securities Principal, and Registered Options Principal. He holds a B.A. in Economics from University of Michigan, an MBA in finance from Howard University, and PhD in public policy and development from Howard University's School of African Studies and Research.

Kevin Kosar

Kevin R. Kosar is Senior Fellow and Governance Project Director with the R Street Institute. He writes on postal issues for a variety of publications including the Brookings Institution's FixGov Blog, and is the co-author of the white paper, "The U.S. Postal Service's Ghost Ship Board." Prior to joining R Street, Kosar spent a decade as a postal analyst at the Congressional Research Service, an agency within the Library of Congress. While there he testified before Congress on postal issues, authored nonpartisan reports on postal legislation and operations, and answered hundreds of questions per year on postal topics. Kosar earned a bachelor of arts from The Ohio State University, and master's and doctoral degrees in politics from New York University.

Jessica Lowrance

Jessica Lowrance is the President-Elect of the Association for Postal Commerce (PostCom). She came to PostCom after working in different positions within the pricing department at the U.S. Postal Service. Her area of responsibility dealt mainly with the many aspects of Negotiated Service Agreements. Jessica has worked with many customers within the industry to develop, file, and implement these customized contracts. She has served as a witness for the Postal Service before the Postal Regulatory Commission. Jessica has been recognized on numerous occasions for her outstanding work within the Postal Service through various departmental awards.

Mark Meitzen

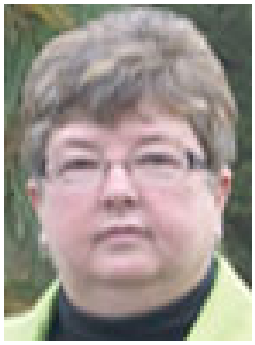
Mark E. Meitzen, Ph.D. is a Vice President at Christensen Associates, an economic consulting and research firm located in Madison, WI. In his work for the Postal Service, Dr. Meitzen has analyzed the implications of various Postal reform proposals dating back to the McHugh bill. More recently, he has contributed to a number of OIG research projects, including an analysis of the CPI-based price cap formula for the Postal Service. Dr. Meitzen's work draws on his expertise in the areas of incentive regulation, incremental cost analysis, pricing, and the measurement and analysis of productivity and service quality. Dr. Meitzen has a Ph.D. in economics from the University of Wisconsin-Madison.

Sharon Owens

Sharon D. Owens is Vice President of Pricing and Costing at the U.S. Postal Service. Owens reports to the Chief Financial Officer and Executive Vice President and oversees programs to strengthen the mailing experience for commercial customers and tailor services for individual markets. She also has oversight of the postal regulatory reporting function, which includes compiling and delivering detailed information on postal programs and services to multiple stakeholders. Owens earned a bachelor's degree in mathematics and a master's degree in operations research from the College of William and Mary.

Lori Rectanus

Lori Rectanus is a Director in GAO's Physical Infrastructure (PI) team, overseeing GAO's audit portfolio for postal issues, federal fleet management, currency and coin production, and federal building security. Internally, Ms. Rectanus has enhanced GAO's human capital management by developing and overseeing processes to facilitate unprecedented levels of hiring, redesigning campus recruitment efforts to better support organizational needs, and implementing tools to enhance employee engagement and productivity. She has received numerous GAO awards. She received a B.A. in Political Science from West Virginia University and a masters in Russian Studies from Georgetown University.



Tonda Rush

Tonda is Director of Public Policy and General Gounsel of the National Newspaper Association (NNA), and Co-director of the Public Notice Resource Center. She was formerly Associate General Counsel/Vice President of Industry Relations for the American Newspaper Publishers Association. She began her career managing and editing a small newspaper in Kansas that she later purchased as part of the Kansas Colloquies publishing group. Tonda has represented newspapers on Capitol Hill since 1983, focusing primarily upon postal issues. She also appears on NNA's behalf before the Postal Regulatory Commission. She has written extensively on First Amendment issues and the concerns of small publishing businesses. Tonda is a graduate of the William Allen White School of Journalism and the University of Kansas School of Law.

Michael Scanlon

Michael Scanlon is a Partner and the Co-practice Leader of the Public Policy and Law Group at the global law firm K&L Gates LLP. Mr. Scanlon's practice concentrates on the postal and maritime industries, administrative procedure and litigation. Mr. Scanlon has extensive experience representing and providing strategic advice to mailers, mail technology companies, and mailing industry associations.

Kathy Siviter

Kathleen Siviter is President of Postal Consulting Services (PCSi), which provides consulting, editorial, and subject-matter expertise on a wide variety of postal issues. Prior to forming PCSi in 2000, Ms. Siviter served for seven years as Vice President for the Association for Postal Commerce (PostCom), where she was responsible for all postal operations, including developing all PostCom's postal operations publications. She previously worked for the U.S. Postal Service for eleven years. Ms. Siviter in 2007 served as the industry co-chair for the Mailers Technical Advisory Committee (MTAC) workgroup tasked with forming recommendations for modern service standards and performance measurement under PAEA.

Keith Weidner

Keith Weidner serves as Chief Counsel, Legal Policy and Legislative Advice, within the Legal Strategy group in the Postal Service Law Department. In this role, Keith focuses on legislative, regulatory, and other postal policy matters, including issues regarding Board governance and the Postal Service's pension and health benefits obligations. He has been with the Postal Service since August 2004. Prior to his current position, Keith served as a Staff Attorney in the Rates and Corporate law groups in the Law Department, with one particular focus being the implementation of the Postal Accountability and Enhancement Act. He is a graduate of the Georgetown University Law Center.

Appendix C: Response From USPS Management

THOMAS J. MARSHALL
GENERAL COUNSEL
AND EXECUTIVE VICE PRESIDENT

UNITED STATES POSTAL SERVICE

March 20, 2017

CHRISTOPHER BACKLEY
A/DIRECTOR, RARC CENTRAL

SUBJECT: Final Review Draft – Service, Cost, and Pricing: A Recap of the 2016 Postal 360 Conference (RARC-WP-XX-XXX)

As we have indicated throughout this process, we have significant concerns regarding the release of the attached document entitled, "Service, Cost, and Pricing: A Recap of the 2016 Postal 360 Conference." As we stated in our recent exit conference, we believe that a summary of the Postal 360 Conference (hereinafter "360 Conference") is both unnecessary and potentially harmful for a variety of reasons. The 360 Conference was a live event held at the Offices of the Postal Service Inspector General on November 16, 2016, and it does not need to be summarized. In fact, any attempt to summarize the live conference runs the risk of unfairly or inaccurately characterizing what was actually said, and in any event a complete audiotape or transcript is available. No matter how well intended, those attempting to summarize the presentations of others will do so from their own perspective making it likely that words and their meaning may be misinterpreted or mischaracterized. In addition, certain presentations and comments may inadvertently be over emphasized while others are given short shrift given the unique sensibilities of the writer.

Moreover, as the summary is being produced by the Office of the Inspector General it necessarily reflects what the staff concluded were the most important aspects of the 360 Conference. Those conclusions as to significance may not be consistent with the views of other participants, including the Postal Service. There is also the issue of the various subtitles throughout the OIG's summary. The subtitles do not appear to have been derived in any way from the 360 Conference itself and have the potential to be inflammatory and to be taken out of context. The same can be said for the quotes that are contained in the summary. Why these particular quotes were chosen is not clear but their selection and placement in the summary give the statements outsized prominence that may not be warranted.

For the reasons stated above and previously, we believe that the practice of summarizing conferences such as the Postal 360 is both unnecessary and potentially harmful. Thank you for the opportunity to provide comments.

Thomas J. Marshall

cc: Ms. Piscioneri
Ms. Haring
CARM
Ms. Glass
E-FOIA

475 L'ENFANT PLAZA SW
WASHINGTON DC 20260-1100
PHONE: 202-268-5555
FAX: 202-268-6981
THOMAS.J.MARSHALL@USPS.GOV
www.usps.com

U.S. Postal Service Office of Inspector General
1735 N. Lynn Street
Arlington, VA 22209

Telephone: 703-248-2100
www.uspsoig.gov

For media inquiries, contact Agapi Doulaveris
Telephone: 703-248-2286
adoulaveris@uspsoig.gov