

GAO

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U.S. POSTAL SERVICE

Challenges in Improving  
Performance and Meeting  
Competition

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# U.S. Postal Service: Challenges in Improving Performance and Meeting Competition

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## Summary

GAO's testimony addresses three major areas that continue to challenge the Postal Service in providing prompt, reliable, and efficient mail services, and thus hinder it from becoming more competitive in the marketplace. These include (1) improving labor-management relations, (2) setting competitive rates and providing competitive service, and (3) controlling operating costs.

The Postal Service continues to have labor-management relations problems similar to some of those GAO reported in 1994. Three of the four unions involved in the last round of negotiations were unable to reach agreements at the bargaining table and had to rely on arbitration to settle their disputes. In addition, the number of employee grievances filed and referred beyond the local management and union levels has increased by 31 percent since 1993. Although other attempts to address employee concerns and improve teamwork are under way, difficulties persist, and not all parties have made commitments to new initiatives. The Postal Service and employee organizations have yet to meet to address GAO's recommendation that they develop and sign a long-term framework agreement outlining overall objectives and approaches for improving both processing and delivery functions of postal operations.

The Postal Service has lost market share to competitors in some areas where it once essentially controlled the market, such as the Express Mail market. It continues to experience problems in competing because of limited flexibility in changing rates and other factors such as less reliable service and not providing certain "value added" services that are provided by competitors. Even in the international mail area, where the Postal Service has greater flexibility in pricing, its rate of revenue growth is well below that of its competitors.

The Postal Service's continued viability as a full-service provider in the current competitive environment depends on, among other factors, its ability to control costs. Labor costs remain the major portion of the Service's operating costs, and it has had limited success in controlling labor cost growth. From April 1993 to November 1995, postal employment grew by 9.5 percent. The Service has efforts to constrain labor costs through a long-term \$5 billion automation program. However, much of the savings produced from automation have been offset by increases in labor costs. Also, its remote barcoding functions are now being performed in-house, which will cost more than in the past, when this function was done under contract. In addition, internal control weaknesses in the

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Service's system for the acceptance of bulk mail as well as some of the Service's purchasing practices have added to its costs.

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## Statement

Dear Mr. Chairman and Members of the Subcommittee:

We appreciate the opportunity to participate in the Subcommittee's oversight hearings on the U.S. Postal Service. My testimony will address three major challenges facing the Postal Service: (1) improving labor-management relations, (2) setting competitive rates and providing competitive services, and (3) controlling operating costs. These issues are not new and the Postal Service is pursuing numerous efforts to provide more prompt, reliable, and efficient mail services as mandated by the Postal Reorganization Act of 1970. My testimony is based on work we have completed over the past several years or have under way.

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## Labor-Management Relations Remain a Problem

In September 1994<sup>1</sup>, we reported that labor-management relation problems persisted on the factory floor of postal facilities. These problems existed between Postal Service management and its four unions representing postal clerks, city carriers, rural carriers, and mail handlers. These employees working conditions, including pay and fringe benefits, are determined through collective bargaining. In recent years, the parties have had difficulties in (1) reaching agreement at the bargaining table and have had to rely on arbitration to settle disputes, (2) reducing the number of grievances elevated beyond local union and management levels to higher levels, and (3) working cooperatively to resolve critical employee morale and teamwork issues. The effects of these problems include poor quality of worklife for many postal employees and higher mail processing and delivery costs for the Postal Service.

In November 1994, collective bargaining agreements with the Service's four major unions expired, and negotiations of all contracts but one—the National Rural Letter Carriers Association contract—ended in impasse, resulting in a need for arbitration. The impasse for the Postal Service and the National Association of Letters Carriers (NALC) resulted because they could not agree on any of the 80 economic and noneconomic issues at the bargaining table. Although the American Postal Workers union (APWU) reached agreement on about 90 noneconomic issues, they did not agree on economic matters and some related work rule issues. The NALC and the

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<sup>1</sup>U.S. POSTAL SERVICE: Labor-Management Problems Persist on the Workroom Floor (GAO/GGD-94-201A and 201B (Vols. 1 & 2), Sept. 29, 1994).

APWU have historically gone into negotiations together but, for the first time since 1970, they negotiated separately. Arbitrators have now made awards in these cases. The Mail Handlers Union and the Service are still in arbitration, and the details will not be made public until April 1996, when an award is anticipated.

An indicator of deteriorating labor-management relations is that in just 3 years—from fiscal years 1993 to 1995—the number of grievances filed and referred to higher management levels for resolution increased by 31 percent. In fiscal year 1993, about 51,800 grievances dealing with disagreements or complaints related to wages, hours, and/or other conditions of employment could not be settled at the local level and had to be elevated to higher levels for resolution. In 1994, the number had grown to about 65,200 and rose to about 73,300 in fiscal year 1995. This was an increase of over 21,000 grievances between 1993 and 1995.

Improving employee attitudes, morale, and teamwork are critical to better mail-delivery performance and customer satisfaction; and Service efforts to make such improvements have been hindered by poor labor-management relations. For example, to identify employee concerns and identify potential management actions, and improve the quality of work life, the Postal Service administered an annual Employee Opinion Survey to over 800,000 employees. In 1995, when the survey was to be done for the fourth year in a row, APWU and NALC, representing over 500,000 employees, asked their members to not respond to the survey. Union officials said that the survey results were inappropriately used against them in the 1994 negotiations. The Service responded that it did not introduce the survey results as a basis for negotiations, but had used our September 1994 report on the Service's labor-management relations in those negotiations. Although some employees did participate in the 1995 survey, the limited results in some areas invalidated the national results to the extent that the Service has abandoned the survey completely. Because the Service still needs to hear the "voice of the employee", it has contracted with an outside firm to do telephone interviews with a sample of employees at each organizational level.

Finally, the Postal Service has recently initiated a top-down, corporate-wide initiative called CustomerPerfect, to improve service quality and customer satisfaction. However, the Postal Service has not gained the support of the labor unions and they are not participating in this overall Service effort. Further, the NALC has asked their members not to attend training, sponsored by the Postal Service as part of

Recommendations for a  
Framework Agreement Have  
Not Been Implemented

its CustomerPerfect initiative, geared to build teamwork and team leader skills. We have reported<sup>2</sup> that the success of this initiative is in doubt without the involvement and commitment of labor union leaders.

The Postal Service has attempted to overcome the difficulties in labor-management relations. The Service agreed with the recommendation in our September 1994 report that the Postmaster General, along with the heads of the four unions and three management associations, which represent general managers, postmasters, and supervisors, develop and sign a long-term framework agreement that outlines overall objectives and approaches for improving employee working conditions. The Postmaster General made an offer that the Service, all four unions, and the three management associations convene a summit and discuss a proposed framework agreement. While the associations agreed, three of the four unions did not agree to attend a meeting at that time because they believed it would have interfered with impending contract negotiations. In our September 1994 report, we recommended that, if the parties could not reach a framework agreement within 2 years from the date of our report, Congress may want to reexamine any aspects of the employee and management relationships that constitute barriers to reaching such an agreement.

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Constraints in Setting  
Postage Rates and  
Providing Competitive  
Services

In the early 1970s, the Postal Service had essentially 100 percent of the Express Mail market; by 1995, its share dropped to about 13 percent. The Postal Service has also experienced a similar decline in its share of the multibillion dollar parcel post market. Unlike its competitors, who can select the markets they serve and set prices according to the demand for and cost of the services provided, the Postal Service, by statute, is required to provide universal service to all communities. The Service is also constrained by law in allocating costs among its various services and setting prices on the basis of market conditions. Noncompetitive postage rates, as well as less reliable services, have contributed to the Service's reduced market share. Even in the international markets where the Service has greater flexibility to set its rates, its volume growth has been considerably less than that of its competitors because the Service has not provided competitive prices and services.

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<sup>2</sup>U.S. POSTAL SERVICE: New Focus on Improving Service Quality and Customer Satisfaction (GAO/GGD-96-30, Dec. 20, 1995).

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Postal Rate Process and Other  
Factors Constrain Rate Setting

We previously reported<sup>3</sup> that the Postal Service is constrained both by (1) the criteria in the 1970 Act specifying how the Service must allocate costs and set postage rates, and (2) the length of the typically 10-month process of changing rates. These constraints have the effect of reducing the Service's flexibility in responding to changes in the marketplace. We said that legislative changes to the 1970 Act's ratemaking provisions will be necessary if the Service is to be more competitive.

Price and Service Quality Are  
Factors Which Hinder  
Competitiveness

Although we believe postal ratemaking is in need of reform and hinders the Service's competitiveness, even with reform the Service could still find competing with private firms difficult unless other improvements in price as well as service quality are made. The importance of service quality is exemplified in the international mail market. Our report<sup>4</sup> on international mail delivery, which we issued this week, explains how the Postal Service, privately-owned firms, and other postal administrations compete with one another in a fast-growing international delivery service market.

In contrast to the process for setting domestic postage rates, the Postal Service has greater flexibility in setting international rates. Interestingly, the international-market research data we reviewed showed that total international revenue for all carriers, including the Postal Service, grew at the rate of 12 percent annually from 1987 to 1992, but the Service's international revenue growth rate was only one-half that rate, at 6 percent. The Service lost business to competitors because of its less competitive rates, less reliable delivery service, and lack of "value-added" services (such as warehousing, inventory, and customs clearance). In the domestic markets, the Service faces similar difficulties. For example, the General Services Administration provides for the federal government's delivery of overnight letter mail under a contract with Federal Express awarded in 1990. Although the Service does not provide a service directly comparable to Federal Express, its Express Mail (overnight) service is similar in many respects, and has a minimum rate of \$10.75.<sup>5</sup> In 1995 it had an on-time delivery rate of about 95 percent. However, Federal Express provides

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<sup>3</sup>U.S. POSTAL SERVICE: Pricing Postal Services in a Competitive Environment (GAO/GGD-92-49, Mar. 25, 1992); U.S. POSTAL SERVICE: Postal Ratemaking in Need of Change (GAO/GGD-96-8, Nov. 15, 1995).

<sup>4</sup>U.S. POSTAL SERVICE: Unresolved Issues in the International Mail Market (GAO/GGD-96-51, Mar. 11, 1996).

<sup>5</sup>This \$10.75 rate could be lower if the Service could justify volume discounts for the General Services Administration and other large customers. However, the Postal Rate Commission has said that a volume discount not based on a cost savings to the Postal Service would be contrary to the 1970 Act. In the 1990 rate case, the Service requested approval to offer volume discounts. However, the Postal Rate Commission disapproved the request because it did not believe the Service had provided data to demonstrate that cost savings could be realized from large customers.

overnight delivery of letters under the contract for only \$3.75, with a monthly on-time delivery rate in 1995 ranging from 96 percent to 98 percent (this excludes the months of partial government shutdown in November and December).

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### Inability to Control Costs Affects Postal Prices and Competitiveness

The Postal Service's continued viability as a full-service provider in the current competitive environment also depends on controlling the cost of operations. The Service is having difficulty in reducing labor costs, as well as strengthening internal operating controls to avoid waste and abuse. Labor costs remain a major portion—82 percent—of the Postal Service's operating costs despite its 1992 downsizing efforts. To meet increased mail volume and make improvements during a downturn in customer satisfaction in 1994, the Service hired additional employees. As a result, Postal Service employment increased from its downsized level of about 782,000 employees in April 1993 to about 855,000 employees in November 1995—a growth of 9.5 percent over that 31 month period.

One major cost savings initiative undertaken by the Postal Service was an attempt to take advantage of emerging technology and improve operational efficiencies by implementing a long-term \$5 billion automation program. This program includes the use of optical character readers and barcodes to automatically sort and process mail, which was to reduce mail employees labor work hours. However, work hours have increased and savings produced from automation have been offset by increases in labor costs.

As part of this automation initiative, in November 1993, the Postal Service agreed with APWU that remote barcoding, which had been done by contractors, would be done by postal employees. This would be performed by a mix of Postal Service employees, both transitional and career. In February 1995, we reported that the Service was not able to barcode as many letters as expected using its optical character readers, and no major breakthrough or significant technological advances are expected in the near future. As a result, the Postal Service was relying on the more expensive remote barcoding function, diminishing much of the anticipated dollar and labor savings.

Later, in September 1995,<sup>6</sup> we reported that performing remote barcoding in-house would cost more than if it were performed under a contract. This

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<sup>6</sup>POSTAL SERVICE: Performing Remote Barcoding In-House Costs More Than Contracting Out (GAO/GGD-95-143, Sept. 13, 1995).



is primarily due to the fact that contract employee costs were lower than the Postal Service's employees wages and fringe benefits. We estimated that, at the ratio of 70 percent transitional and 30 percent career workforce required by the Service-union agreement, the cost differential between Postal Service and contractor barcoding would be about 14 percent or \$86 million (not adjusted for inflation) to process 23 billion letters annually. Furthermore, an issue still unresolved is whether the Postal Service and unions will decide to have transitional employees receive benefits similar to career employees. If this were to take place, we estimated that the cost difference would be even higher at 28 percent, or about \$174 million annually. As such, if all barcoding was performed by career employees, we estimated that in-house barcoding costs would exceed contracting costs by 44 percent, or \$267 million annually—thus, resulting in the Postal Service incurring greater labor costs in this aspect of the automation initiative.

Internal operating controls are another critical element in avoiding unwarranted costs. For example, in January 1996<sup>7</sup>, we reported that Service officials did not follow required procedures for seven real estate or equipment purchases in order to meet what they, in some instances, believed to be the need to expedite the procurement process. In some cases, the Service failed to resolve conflict-of-interest situations identified—both real and apparent. For example, contrary to the advice of the Postal Service's legal department, the contracting officer failed to resolve a conflict of interest on the part of an individual who helped evaluate the contract proposals and at the same time had a job offer pending from the successful offeror. As a result of the conflict of interest, the award was set aside by the courts and a replacement contract was awarded to one of the unsuccessful offerors. The Service paid \$10 million to the original winning offeror to settle its claim under the contract, which was then set aside. Also, the new contract cost \$8 million more annually than the old contract. Overall, we estimated that in these seven purchases, the Service expended about \$89 million on penalties or unusable and marginally used property, portions of which could be recovered if the properties were leased or sold.

Another example of internal control weaknesses that we plan to report on in the future involves the Postal Service's controls over discounted bulk business mail. This is a significant portion of the Service's business—almost one-half of its total revenue of \$47.7 billion is from such

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<sup>7</sup>POSTAL SERVICE: Conditions Leading to Problems in Some Major Purchases (GAO/GGD-96-59, Jan. 18, 1996).

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bulk mail. The Service has a system designed to verify postage due on bulk mail which enabled it to avoid losing revenues of \$168 million in fiscal year 1994. However, the system has internal control weaknesses that increase the risk that the Service is losing significant revenue on discounted bulk mail. For example, while the Service has annually received billions of pieces of barcoded mail—and the volume is expected to increase in future years—acceptance clerks at mail processing plants do not have adequate automated equipment to verify the readability of mailer-applied barcodes. Also, these clerks have not always done required verifications because of the urgency to accept and deliver mail.

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Mr. Chairman, this concludes my prepared statement. I have appended a list of our Postal Service products issued since January 1995. I would be happy to respond to any questions.

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# GAO Postal-Related Products Issued January 1, 1995 Through March 12, 1996

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U.S. POSTAL SERVICE: Unresolved Issues in the International Mail Market (GAO/GGD-96-51, Mar. 11, 1996).

U.S. POSTAL SERVICE: A Look at Other Countries' Postal Reform Efforts (GAO/T-GGD-96-60, Jan. 25, 1996).

POSTAL SERVICE: Conditions Leading to Problems in Some Major Purchases (GAO/GGD-96-59, Jan. 18, 1996).

U.S. POSTAL SERVICE: New Focus on Improving Service Quality and Customer Satisfaction (GAO/GGD-96-30, Dec. 20, 1995).

Postal Employment and Barcoding (GAO/GGD-96-54R, Dec. 15, 1995).

U.S. POSTAL SERVICE: Postal Ratemaking in Need of Change (GAO/GGD-96-8, Nov. 15, 1995).

POSTAL SERVICE: Performing Remote Barcoding In-House Costs More Than Contracting Out (GAO/GGD-95-143, Sept. 13, 1995).

POSTAL SERVICE: Mail Delivery Service in the Washington Metropolitan Area (GAO/T-GGD-95-94, Feb. 28, 1995).

D.C. AREA MAIL DELIVERY SERVICE: Resolving Labor-Relations and Operational Problems Key to Service Improvement (GAO/GGD-95-77, Feb. 23, 1995).

POSTAL SERVICE: Many Challenges in a Changing Environment (GAO/T-GGD-95-93, Feb. 23, 1995).

POSTAL SERVICE: Automation Is Taking Longer and Producing Less Than Expected (GAO/GGD-95-89BR, Feb. 22, 1995).

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