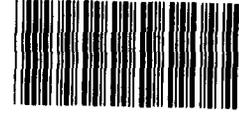


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Postage Stamp Production and Procurement

Statement of L. Nye Stevens
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Operations Issues
General Government Division

Before the Committee on
Post Office and Civil Service
Subcommittee on Postal Operations
and Services
U.S. House of Representatives



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POSTAGE STAMP PRODUCTION AND PROCUREMENT

SUMMARY OF STATEMENT BY L. NYE STEVENS DIRECTOR, GOVERNMENT BUSINESS OPERATIONS ISSUES GENERAL GOVERNMENT DIVISION

The current working relationship between the Postal Service and the Bureau of Engraving and Printing for the production of postage stamps represents a major improvement of the situation GAO reported to the Committee in 1989. By 1988, the relationship between the two agencies had become severely strained and the Postal Service proposed that all stamp production should be contracted out to the private sector within 5 years. Today, Postal Service and Bureau officials agree that their relationship is much more harmonious as the result of a 1990 formal interagency agreement spelling out detailed understandings and procedures.

GAO nevertheless observes that potential developments in four areas could threaten the Bureau's long-term postage stamp production role. First, technological changes in both the information transmission industry and in the product itself could reduce the demand for water-activated stamps. Past growth levels may not be achieved in the future if electronic information transmission erodes first-class mail volume, or if self-adhesive stamps (which the Bureau does not make) become more commonly used.

Second, if public demand for water-activated stamps does not increase as the Postal Service has forecast, the number of stamps printed by the Bureau could fall below optimum capacity because of the Postal Service's commitment to share from 20 to 30 percent of production with the private sector. Excess capacity could result in the Bureau's stamp prices being uncompetitive with the private sector.

Third, the Postal Service has made it clear that it will not compromise its demands for high quality, reasonable costs, and on-time delivery. The 1990 interagency agreement spells out extensive quality control procedures, and the Bureau has launched a promising Total Quality Management initiative.

Fourth, the agencies continue to disagree on the extent to which the condition and layout of the Bureau's downtown Washington production facility, the newest part of which is 53 years old, affects production efficiency.

Mr. Chairman and Members of the Subcommittee:

We welcome this opportunity to discuss issues relating to postage stamp production as well as the status of the relationship between the U. S. Postal Service and the Bureau of Engraving and Printing. My testimony will update the report we issued to the Committee Chairman in December, 1989, entitled POSTAGE STAMP PRODUCTION: The Bureau of Engraving and Printing's Future Role (GGD-90-25).

In updating the issues affecting postage stamp production, we met with the Director and key officials at the Bureau of Engraving and Printing. At the Postal Service, we talked to the Director, Office of Stamps and Philatelic Marketing and the General Manager, Stamp Manufacturing Division. We gathered and analyzed recent stamp production and forecast data, reviewed the results of Deloitte & Touche's Study of Stamp Production via the Private Sector, and analyzed the June 1990 Agreement Between The Bureau Of Engraving and Printing and The United States Postal Service for Production of Postage Stamps. We also analyzed reports from the Bureau and the Postal Service to the Committee Chairman on actions taken in response to our report's recommendations.

THE RELATIONSHIP BETWEEN THE POSTAL
SERVICE AND THE BUREAU HAS IMPROVED

There is no question that the current working relationship between the Postal Service and the Bureau represents a major improvement over the situation in the late 1980s that is reflected in our 1989 report to the Committee. Then, frequent disagreements over quality and cost issues overlay a fundamental difference over what the relationship should be. The Postal Service felt that the Bureau was simply a supplier and postal requirements should not be negotiable. The Bureau noted that it had been producing stamps for nearly a century and should be accorded status as a partner. By 1988 the relationship had become so strained that oral communication virtually stopped and stamp requirements were transmitted in writing only. In June, 1988 the Postmaster General wrote the Secretary of the Treasury resurrecting a 1982 privatization initiative by Treasury, and suggested that all postage stamp production should be contracted out to the private sector within 5 years.

Today, Postal Service and Bureau officials agree that the acrimonious relationship that divided the two agencies in past years no longer exists. Both ascribe this improvement to the development, in response to our recommendations and encouraged by the Committee's continuing interest, of a formal interagency agreement that was worked out over several months of intensive negotiations. The agreement has the stated purpose of providing

the Postal Service with a reliable source for stamp production and providing the Bureau with a commitment by which it can project long term planning of capital investment, research and development, inventory of supplies and personnel needs. The agreement spells out detailed understandings and procedures in such areas as quality standards and verification, auditing of costs, communication responsibilities, and production leadtimes.

The agreement, which was signed in June 1990, was initially established for a period of 5 years but can be renewed annually for additional 1-year periods. This enables the agencies to have a 5-year agreement constantly in effect if they so choose. According to officials at both agencies, the agreement provides a mechanism for resolving whatever future problems may arise.

POTENTIAL FUTURE ISSUES

The actions taken by both the Postal Service and the Bureau have been completely responsive to our recommendations, and we have no doubts that the relationship between the two agencies has improved greatly on the basis of the 1990 agreement. However, it would be unduly optimistic for the Subcommittee to conclude that the present role of the Bureau of Engraving and Printing in the production of postage stamps is assured for the indefinite future. We identified potential developments in four areas that could threaten the Bureau's role in the future: technological

changes, the Postal Service's commitment to maintaining active competition, attention to quality, and the Bureau's physical plant.

Technological Changes

The market for postage stamps has become more dynamic and less predictable in recent years as a result of technological changes in the mailing industry and other forms of information transmission. This makes forecasting the demand for postage stamps, on which the Bureau's short-term planning and long-term investment strategy is dependent, a difficult and inexact endeavor. The Bureau believes that its optimum stamp production level is between 35 and 40 billion stamps annually. Its confidence of a continuing role as the core stamp producer is based in part on a Postal Service estimate that from 63 to 84 billion stamps will be needed annually by the year 2000, leaving room both for full Bureau production and a healthy private industry share. This estimate is based in turn on projections of a compounded annual growth rate of from 4 to 6.5 percent, substantially higher than the actual growth rate of 2.6 percent annually from 1979 to 1989.

However, technology could affect the growth of stamp demand in the future. About 83 percent of stamps are used on first-class mail. While the Postal Service expects to retain its monopoly on

first class mail indefinitely, it nevertheless faces growing indirect competition--from FAX machines, electronic information dissemination and funds transfer, and telephone billpaying--that could eventually make inroads into first-class mail volume, particularly if postage costs continue to rise faster than inflation. Third-class mail, the next largest user of stamps, also faces growing competition from alternative delivery services, which were given a boost by the latest rate decision.

A second way that technology can change stamp demand is in the composition of the product itself. The Postal Service is seeking private sector suppliers for new technology stamps including plastic stamps and self-adhesive stamps which can be dispensed through automatic teller machines. According to postal officials, these new stamps are popular with the public and demand for them is expected to grow much faster than demand for water-activated stamps produced by the Bureau. The Bureau does not produce self-adhesive stamps.

Commitment to Competition

If the Postal Service's demand forecasts prove to be overly optimistic, and the demand for water-activated stamps proves to be flat rather than growing, the Postal Service's commitment to developing a strong private sector alternative for stamp production could threaten rather than supplement the Bureau's

role. The new interagency agreement details the percentage of water-activated stamps the Bureau will produce each year over the next 5 years; specifically, it states that the Bureau will provide 80 percent in FY 1991, 75 percent in FYs 1992 and 1993, and 70 percent in FYs 1994 and 1995. Postal Service officials said they are using these provisions of the agreement to let potential contractors know that the production of water-activated stamps above the percentages specified in the interagency agreement, as well as the production of all plastic and self-adhesive stamps, will be contracted out to the private sector. They said this commitment to contracting out is creating a new private sector industry for stamp production that did not previously exist. Ultimately, the Postal Service believes this competitive strategy will provide it with the best mix of quality stamps delivered in a timely manner at the best possible price.

However, as the Bureau has pointed out, if public demand for water-activated stamps does not increase as the Postal Service has forecast, the number of stamps to be printed by the Bureau could actually decrease because of the Postal Service's commitment to share production with the private sector. According to Bureau officials, if the Postal Service's forecasts do prove overly optimistic, the Bureau will not be producing a sufficient number of stamps to keep its presses operating at optimum efficiency of between 35-40 billion stamps annually.

Since the Bureau is required to recapture all its expenses in the prices it charges the Postal Service, Bureau officials said that inefficient utilization of capacity will result in the Bureau's stamp prices rising. This would weaken the Bureau's position when negotiating with the Postal Service for future business. Because of this, the Bureau believes future extensions of the agreement should guarantee it a specified amount of stamp orders, commensurate with the efficient use of its capacity, rather than a percentage of the overall production amount. The Postal Service believes that this would conflict with its commitment to build a strong private sector alternative.

Attention to Quality

In the past and in most of its current activities, the Bureau of Engraving and Printing has been shielded from competition. Its incentive for quality performance arose from pride and tradition, not fear of displacement. Its other major function--currency production--is unlikely ever to be contracted out. There is no legal requirement that the Postal Service procure its stamps from the Bureau, however, and as we have noted, it is firmly committed to developing a private sector capacity precisely to secure the virtues of competition among its suppliers. It expects its suppliers to be responsive to each of its three priorities: stamp quality, reasonable costs, and on-

time delivery. As detailed in our 1989 report, the Postal Service was not fully satisfied with the Bureau's performance in any of these categories.

With regard to stamp quality issues, Bureau and Postal Service officials agree that the new interagency agreement should enhance quality control. The Bureau has developed a quality assurance manual and a quality practices manual which detail the policies and procedures of its quality assurance efforts. The interagency agreement further states that the Postal Service is to provide the Bureau written product standards for each product type, and that any problems are to be discussed with the Bureau at regular quality meetings. Officials of both agencies are hopeful that these new quality assurance initiatives will head off quality disputes and problems that characterized the period before the agreement.

While we believe the complaint resolution aspect of quality control has its place, we ascribe equal importance to the commitment of the Bureau to a Total Quality Management (TQM) initiative that it is in the process of implementing throughout the agency. TQM has three main components: a concentrated focus on customer needs, continuous efforts to improve quality and customer service, and total organizational involvement in quality improvement efforts.

The Bureau's plan for implementing TQM is still under review by management, and it is too early to assess whether the Bureau will make the total organizational commitment that other entities have found essential to success of a TQM initiative. Should the Bureau follow through, however, the principles of the TQM program should lead inevitably to a continuous improvement in stamp quality and to the Postal Service's recognition of it.

The Bureau's Facility

Postal officials continue to believe that for the long run, in order to produce stamps competitively, the Bureau will have to seek a modern production facility. The Deloitte & Touche study recommended that both agencies "begin a program to replace the aged, multistory facility in which BEP currently operates.... (I)ts significant age and inefficiencies are increasingly affecting the efficient production of stamps."

The Bureau disagrees that the layout and condition of its current facility is affecting the efficient production of stamps. However, it has agreed, with some conditions, to participate in a preliminary site selection assessment for an alternative facility if the Postal Service requests one. There is no question that disagreement between the two agencies on the relationship between the Bureau's facility and the quality and

costs of its stamp output is a deep division that has not been resolved by the interagency agreement.

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In summary, Mr. Chairman, we believe the situation between the Bureau and the Postal Service is much improved, and that the agreement has resulted in a more businesslike arrangement. There are, however, still some uncertainties about the long-term outlook for the Bureau's role in producing postage stamps cost efficiently. Because the Postal Service is not required by law to purchase all or any of its stamps from the Bureau, the Bureau's future as the nation's stamp producer cannot be assured. In our opinion, it should not be. Competition is a healthy incentive toward excellence of performance. Given this, the Bureau's Total Quality Management initiative, properly implemented, should provide more dependable assurance of a thriving public sector stamp production than would a legislated monopoly.

That concludes my prepared statement. My colleagues and I would be pleased to respond to questions.

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