COALITION FOR A 21st CENTURY POSTAL SERVICE

A Postal Primer: The Basics and Pivotal Issues Affecting the Future of the United States Postal Service

April 16, 2019

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KEY TAKEAWAYS

The Postal Service is self-sustaining: it receives no taxpayer dollars, deriving its revenues from postage. The Postal Regulatory Commission serves as a check on its rate, classification and some other powers.

USPS serves every citizen and business everywhere, every day: 158 million addresses. It is a crucial service in Rural America, and around the country.

It delivered more than 146 billion letters, cards, periodicals, packages, prescriptions and much more last year alone.

It employs about 500,000 career and 635,000 total personnel, including 100,000 veterans, and is the beating heart of a $1.4 trillion industry.

It is in serious financial trouble in part because its core mailing business is steadily diverting online. But its package segment has grown dramatically, generating $7 billion toward overhead, nearly 25% of the total.

Notwithstanding the speedy erosion of its mail base, USPS has still managed to cut costs and operate in the black over the past few years. The losses are caused by a statutory obligation to "prefund" its retiree healthcare to 100% - virtually alone among public or private sector entities.

Integrating the 20% or so of its retirees who do not now subscribe into Medicare, as laid out in bipartisan legislation in the previous two congresses, would eliminate that obligation. All such retirees are eligible for Medicare, and have paid Medicare taxes for decades.

Investment of some of its funds in conservative instruments much like the Thrift Savings Plan would nearly triple the yields it receives from Treasuries and help alleviate its prefunding abilities.

EXECUTIVE SUMMARY

The United States Postal Service (USPS, Postal Service or the Service), which anchors a $1.4 trillion-dollar mailing industry that employs 7.5 million workers, is insolvent. In Fiscal Year 2018, USPS lost nearly $4 billion. It has defaulted on various retirement obligations totaling $43 billion. Its volume has continued to decline, to 146.4 billion pieces, 31% below its peak in 2006, while its number of delivery points increases annually by more than one million to a record 158.6 million in 2018.

In the Topics included in this Primer, the Coalition for a 21st Century Postal Service provides focused, brief discussions on both the basics of the postal system and critical issues confronting it. We intend this to be a convenient reference work, with this executive summary to offer a quick tour through the various Topics.

Buoyed over the last few years by a rapidly expanding package business largely stimulated by the phenomenal growth in e-commerce, USPS' growth in that sector has begun to slow as competition has intensified. Plus, expenses have increased with the larger volume of more-labor intensive packages to deliver and labor contracts providing raises and cost-of-living adjustments. Its vehicle fleet has passed its useful life expectancy and urgently needs the multi-billion-dollar replacement program upon which the Service has embarked. And, its debt remains at historically high levels, only recently declining moderately from the maximum permitted by law.

The Postal Accountability and Enhancement Act of 2006 (PAEA) requires the Postal Service to fund 75 years of health benefits for current and future retirees – all of them, not just those who are retired or vested in the program. That indiscriminate prefunding was front loaded over the first ten years, costing approximately $5.5 billion a year. The Service's financial inability to make those payments in multiple years accounts for most of its default total. Currently, USPS is required to make payments on the remainder of its retiree health liability amortized over 40 years. This has cut the annual prefunding payment in about half to $2.4 billion per year. Nonetheless, USPS continues to default. The amortized prefunding, and the contribution the USPS pays as the employer's share of annuitants' premiums ("normal costs"), account for more than nine percent of its annual expenses. This aggressive payment schedule is not the only challenge facing the Postal Service. Others include the changing nature of communications, inexorably declining volume and revenue, and an extensive and costly infrastructure that needs further realignment.

The Coalition for a 21st Century Postal Service offers this primer on the key issues affecting the future of the United States Postal Service. These issues are at the heart of the challenges facing the entire mailing industry, which supports 7.5 million jobs throughout the United States. The ten educational Topics comprising the primer focus on the following key issues:

- **Foundation of a 1.4-Trillion-Dollar Industry** – The USPS is the delivery system for the $1.4 trillion a year mailing and shipping, which is responsible for 7.5 million jobs – almost 7 million in the private sector – in this country. The industry includes those organizations that communicate by mail, such as catalog companies, publishers, charities, advertisers and transactional mailers (banks, insurance companies, utilities, retail telecommunications companies), as well as those that support these businesses, including printers, paper companies, technology companies and other service providers. It also includes a vibrant package and parcel business, which has become a true bright spot for USPS. These businesses and organizations rely on a healthy and affordable postal system to communicate with customers and promote commerce. Households rely on the mail to communicate and receive goods that are fulfilled through the postal system.

- **A Precipitous Decline in Volume and Revenues** – After its all-time high of 213 billion pieces in 2006, mail volume has fallen to its lowest level in decades, with First Class Mail now at levels last seen in 1986. A persistent decline in volume shows no sign of abating. Since the Postal Service earns its revenues from the sale of postage, the decline has been disastrous for its finances. Specifically, USPS net losses over the past three years have topped $12 billion. The Postal Service has focused greater attention on reducing costs and raising revenue, but it has few tools with which to achieve revenues greater than its costs.

- **Package Delivery Expansion Crucial to Sustaining the System –** Since PAEA freed the Postal Service to compete in the market for package services, volume and revenues from packages at first increased, and then boomed with the ecommerce explosion. Packages have been a rare bright spot, and a very bright one indeed for USPS, now contributing more than $7 billion to postal institutional costs or overhead – a rough approximation of profit. That $7 billion amounts to nearly 25% of institutional costs and has made up a large part of the gap caused by the decline in Market Dominant (MD) mail. MD mail is comprised of classes of mail over which the Postal Service continues to have a monopoly.

- **Overview of Postal Service Labor Costs and Contracts** -- Labor costs account for approximately 76 percent of total USPS expenses, a percentage that has not appreciably changed in 35 years despite major investment in automation equipment and streamlining of its structure, With much greater package volume, and unrelenting additions to addresses served (more than a million added per year; current total exceeds 158 million), costs have mounted in recent years despite USPS' best efforts to reduce them. This is because the Service is labor-intensive with about 497,000 career and 137,000 non-career employees, who receive an average annual compensation (wages and benefits) of almost $79,000. Collectively bargained contracts with its unionized workforce restrict USPS' ability to reduce headcount when business conditions warrant. Work rules negotiated in contracts limit reassignments and other adjustments that would yield operational cost savings. These contracts, which set the terms and conditions for wages, benefits and conditions of employment, are generally up for renewal on a four-year cycle. The negotiation of new contracts presents an opportunity to tailor them to the economic realities of the postal system. But present statutory rules for arbitration (mandated absent agreement) do not require arbitrators to consider USPS's financial condition.

- **Postal Service Retiree Health Benefits Fund** – The Postal Accountability and Enhancement Act of 2006 (PAEA) established a prefunding plan for the Postal Service Retiree Health Benefits Fund because of concern that a future postal system would be smaller and unable to cover the costs of retiree health benefits. However, the payment schedule was more concerned with federal budget neutrality than with sound actuarial practices. As a result, the too-aggressive payment schedule has dramatically damaged the USPS balance sheet, resulting in defaults of $43 billion in payments to date, as the Service chooses to continue delivery of mail over a prefunding requirement (100% funding for 75 years of retiree health) faced by literally no other public or private sector entity. It cannot afford both.

- **Statutory Limitations on Debt and USPS Inclusion in the Unified Federal Budget** – The law limits the Service to a net annual increase in debt of $3 billion. Total outstanding debt cannot exceed $15 billion. The Postal Service had reached that statutory limit years ago, and only in the last year has reduced the total by more than $1 billion. Prior to health benefits prefunding along with the Great Recession and the advent of smartphones and social media, USPS was for a short time practically debt-free. However, these three factors have wreaked havoc on the Postal Service's bottom line. Complicating efforts to remediate this problem is the fact that the Postal Service's contributions for its retiree obligations are held in "on budget" accounts, so reductions in these payments have a negative effect on the federal deficit. A net negative change in budget score commonly raises political difficulties.

- **Large Postal Network and Retail Presence** – The Postal Service's approximately 35,000 retail outlets (USPS and contract) number more than all the Starbucks, McDonald's and Wal-Marts combined. Despite major changes in the way Americans communicate – and the resulting reduction in mail they send – the number of retail outlets has not changed dramatically. The reason is that USPS cannot simply close a post office, no matter how justified by operations or economics. The law, as overseen by the Postal Regulatory Commission, permits the public to appeal from proposed closings. The Postal Service has a separate process for closing or consolidating operations at its mail processing facilities, which it has done twice. Despite the need for even further change, USPS regularly faces congressional opposition to closing facilities primarily because of the implications for jobs within the localities affected.

- **Reducing the Number of Delivery and Processing Days –** An initiative previously pursued by the Postal Service has now been rendered essentially moot. The package marketplace increasingly demands 7-day delivery, which the Postal Service is attempting to meet to stay competitive. The savings originally postulated for reducing delivery days were shown to be much lower after extensive review by the Postal Regulatory Commission. And, as a practical matter, the Postal Service would need authorization from Congress. Appropriations language annually requires 6-day delivery, at least, and in each Congress, resolutions opposing reducing delivery days regularly receive substantial, bipartisan, majorities.

- **Recommendations from the President's Task Force on the Postal System.** The President created a Task Force on the Postal System in 2018 whose Report, released in December of last year, was focused on taking steps to make the Postal Service sustainable without burdening taxpayers. The Report was a mixed bag, finding that sustaining the postal universal service obligation was vital, worksharing and continued outsourcing of some functions were pivotal, and revising the obligation for prefunding retiree healthcare would be quite significant. It did not endorse privatizing the system. However, the Task Force also recommended splitting the mailtstream into "essential" and other products, which would prove to be grossly inefficient, raising prices on both mail and packages with no limits but self-restraint, adopting "Fully Distributed Costing" for cost allocations and more. Any of those and others would be extensively problematic for the system, in that they would drive mail, packages and revenues out of the system at an accelerated pace, confuse the public, as well as mailers and shippers, and much more. These changes would not help the system; they would undermine it.

The mailing public, the mailing and shipping industry, and the Postal Service and its employees all expect and must have a sound postal system that is on firm financial footing for the future. Therefore, the Coalition for a 21st Century Postal Service urges all stakeholders to consider carefully the topics summarized above in making decisions that will determine the future of a postal system that remains at the core of American commerce and communications in the 21st Century.

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TOPIC 1: THE FOUNDATION OF A $1.4 TRILLION INDUSTRY

For 243 years, "the national post office has bound the country together and advanced commerce by enabling the exchange of goods, ideas and information," noted an influential report by a presidential commission that studied the U.S. Postal Service in 2003. Its role as the one government entity that touches every American every day is frequently recognized, and it does so with no taxpayer dollars: all of its revenues come from postage.[1] As important – but not always appreciated – is the Postal Service's role in the nation's economy.

It is the engine that drives a $1.4 trillion mailing and shipping industry, which is responsible for about 7.5 million jobs in this country, according to a 2015 study by the Envelope Manufacturers Association Foundation Institute for Postal Studies. It constitutes about 6% of GDP. Virtually every business in this country relies on the Postal Service. For example, the Postal Service is the primary advertising vehicle for small businesses, which employ 52 percent of all U.S. private sector workers. For some businesses and organizations, the postal system is a core business factor.

<u>What the industry comprises.</u>

The mailing and shipping industry comprises those organizations that communicate by mail, such as catalog companies, publishers, charities, advertisers and transactional mailers, those that drive and rely upon package services, e-commerce and prescription fulfillment companies, among others, as well as those that support these companies, including printers, paper companies, technology suppliers and other service providers. See chart below.

MAILING INDUSTRY JOB BY TYPE

Job Category	Total Jobs
Mail Production and Distribution	
Postal Service	617,254
Private sector delivery and suppliers	786,759
Paper, printing, suppliers, and design	605,864
Mail Production and Distribution Total	**2,009,877**
Management of Mail in All Industries	1,834,916
Self-employed Mail Intensive	249,989
Management of Mail in All Industries Total	**2,084,905**
Jobs Due to Sales of Products and Services	
Catalog based sales	447,906
Non-catalog based direct mail sales	2,192,452
Direct Response magazine ad sales	278,080
Insert Advertisement Sales	102,973

[1] A very small amount of funds – a fraction of 1% -- is supplied by the Treasury to fund mailings for the blind and other worthy purposes. In Fiscal Year 2018, about $58.1 million was appropriated for so-called "revenue foregone."

Publishing jobs not counted elsewhere	105,173
Electronic shopping and Mail Order Houses	208,820
Retail sales delivered by Retailers with Stores	56,641
Jobs dues to Sales of Products and Services Total	**3,392,045**
TOTAL JOBS	**7,486,827**

Source: EMA Foundation Institute for Postal Studies, 20082015 EMA Mailing Industry Job Study

These businesses and organizations rely on affordable universal service to communicate with customers and promote commerce. Households rely on the mail to communicate and to receive goods that are fulfilled through the postal system.

USPS would be 40^{th} on the FORTUNE 500.

While the Postal Service, were it a private company, would rank fortieth on the 2018 Fortune 500 list, it is important that in one respect it *does* resemble a private firm: it pays for its operations, as noted above, through the sale of postage and services and not tax dollars (other than a few million appropriated for Congressionally-mandated public services). This is one main reason why the Service is central to the mailing industry – not merely a government agency which affects that industry.

On its own, the Postal Service is a sizable employer. But the broader economic implications are rooted in its role as the foundation of a large “mailing and shipping” industry, which supports about 7.5 million jobs in this country. The importance of a viable postal system to this country’s economy should not be minimized or dismissed.

TOPIC 2: A STEADY DECLINE IN VOLUME AND REVENUES

In 2006, total mail volume hit its all-time high of 213 billion pieces. Since then, however, the Postal Service has lost nearly 67 billion pieces of mail, or nearly one third of its business. It expects to continue to lose First Class mail, its most profitable Market Dominant[2] product class, at low single-digit percentages per year. At the same time, the Service has been somewhat buoyed financially by growing package volume from the e-commerce fulfillment explosion. See Topic 3 starting at p. 9. This is a monumental decline in mail volumes, notwithstanding the additional package volume, unlike any in Postal Service history.

To put this in perspective, in the entire Twentieth Century, the Postal Service experienced year-over-year volume declines only seven times. In the first nineteen years of this century, the Postal Service has had annual volume declines sixteen times. Its loss of 26 billion pieces in 2009 marked the largest single-year loss in its history. Mail volumes are now at the same level they were in 1986.

The 2003 presidential commission that addressed the challenges facing the Postal Service predicted a "grim" 15-year financial outlook for the Postal Service, estimating that mail volume would fall from 203 billion to 182 billion by 2017. In fact, it declined much further – to just over 150 billion, with a further drop to just over 146 billion in 2018.

Volume growth is essential to the Postal Service's financial health. Because the Service earns its revenues from the sale of postage, declining mail volume hurts revenues. Operating revenue has essentially been dropping on an inflation-adjusted basis since 2007, although its absolute dollars have held up because of steady inflation- indexed increases, a lengthy surcharge for the "exigent circumstances" caused by the Great Recession, and growth in its competitive package business. The Postal Service's perilous financial situation has led the Government Accountability Office (GAO) to maintain USPS on its high-risk, or vulnerable, list since 2010.

OPERATING RESULTS (in billions)

	FY 2006 ACTUAL	**FY2018 ACTUAL**	**CHANGE**	**% CHANGE**
Volume	213.1	146.4	(66.7)	-31.3
Revenue	$72.6	$70.7	($1.9)	(2.6)
Operating Expenses	$ 71.7	$74.4	$ 2.7	3.7
Retiree Health Benefits Payments	$1.6	$4.5	$2.9	181
Net Gain (Loss)	**$0.9**	**($3.7)**	**($4.6_**	-511

[2] The statute makes most "traditional" mail products "market dominant," with prices set by an inflation-related price cap. Where the Postal Service faces competition from the private sector, as in most package products, the statute gives it much more pricing freedom.

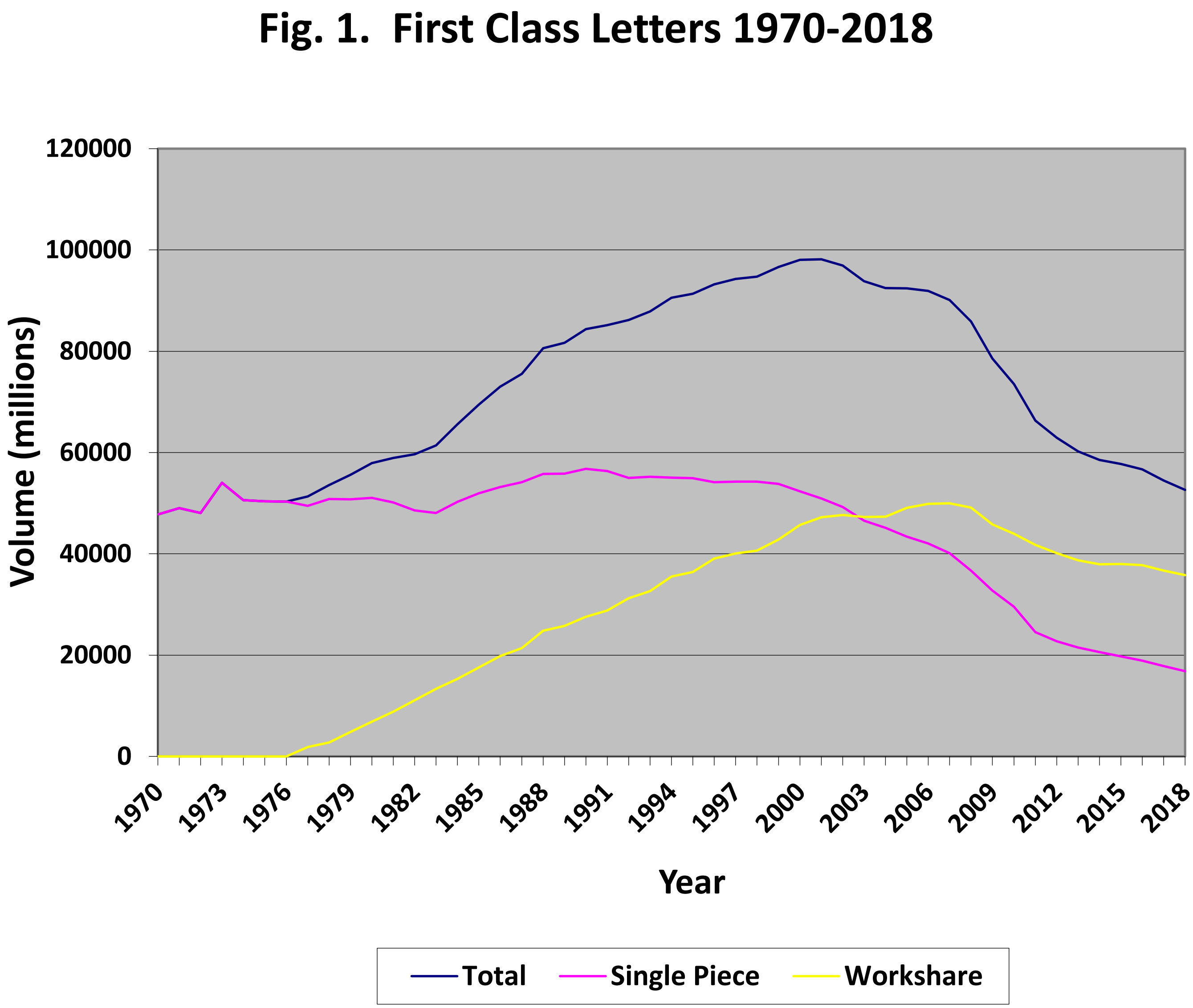
Sources: U.S. Postal Service Annual Report 2006 and Form 10-K 2018.

Long-term volume predictions are difficult to make.

The Presidential Commission, featuring some of the foremost business executives and postal experts of the time, for example, took into account many factors but of course could not, in 2003, predict a collapse in the housing market and the financial services industry, which led to a sustained recession. It equally could not predict the stunningly fast migration from mail to electronic communications, nor the equally stunning rise in e-commerce and its fulfillment. Mail use, in particular advertising mail, is affected by economic conditions. While single-piece First Class Mail has been steadily declining due to electronic diversion since 1990, other types of mail, notably Commercial First Class and Standard Mail, had seen steady growth until a decade ago. Now, with proliferating alternative communications and marketing channels – email, social media, streaming. QR codes to landing pages, websites generally, pop-ups and banners, and many more in the electronic sphere, as well as broadcast and print – transactional mail, direct mail and catalog marketing face unprecedented challenges.

On the other side of the coin, they of course could not predict the explosion in ecommerce and the boon that would bring to the USPS in the form of packages and parcels. There will be a more fulsome discussion of the Competitive – i.e., packages and parcels, predominantly – side of the Postal Service's business in Topic 3 starting at page 9.

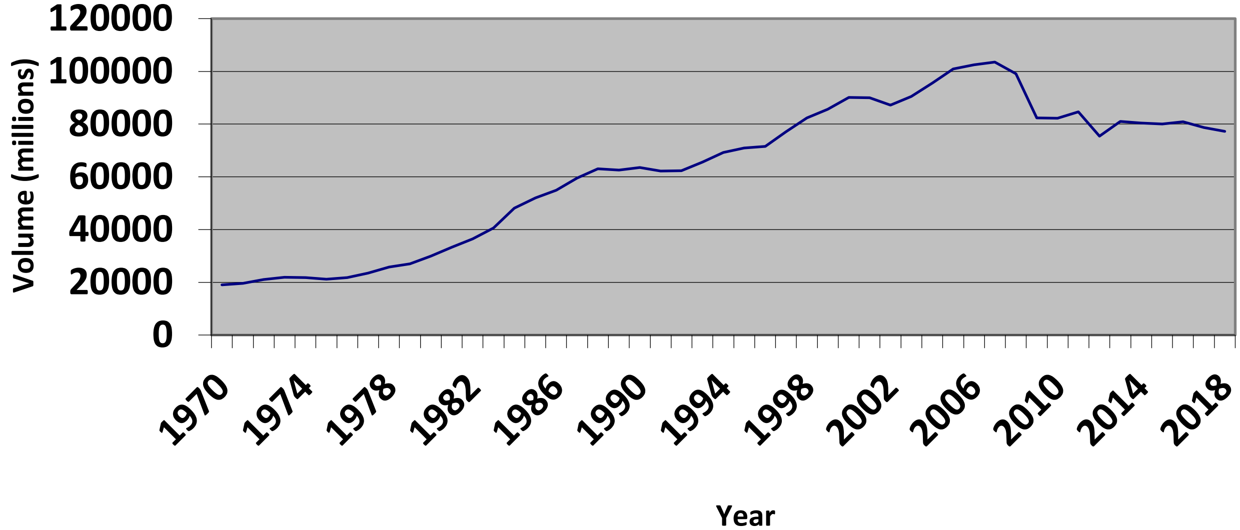
The first chart below illustrates the trend in First-Class Mail Letters, as a whole, and differentiated between Single-Piece and Presort (Commercial) First Class:



Sources: USPS Domestic Volume History 2017, FY 2018 Public Cost and Revenue Analysis

The next chart (Fig. 2) displays the trend in bulk marketing mail – at different times, called Third-Class Mail, Standard Mail, and USPS Marketing Mail:

Fig. 2. Third Class/Standard/Marketing Mail 1970-2018



The next chart (Fig. 3) shows total mail volume, but indexed for the 1990-2018 period:

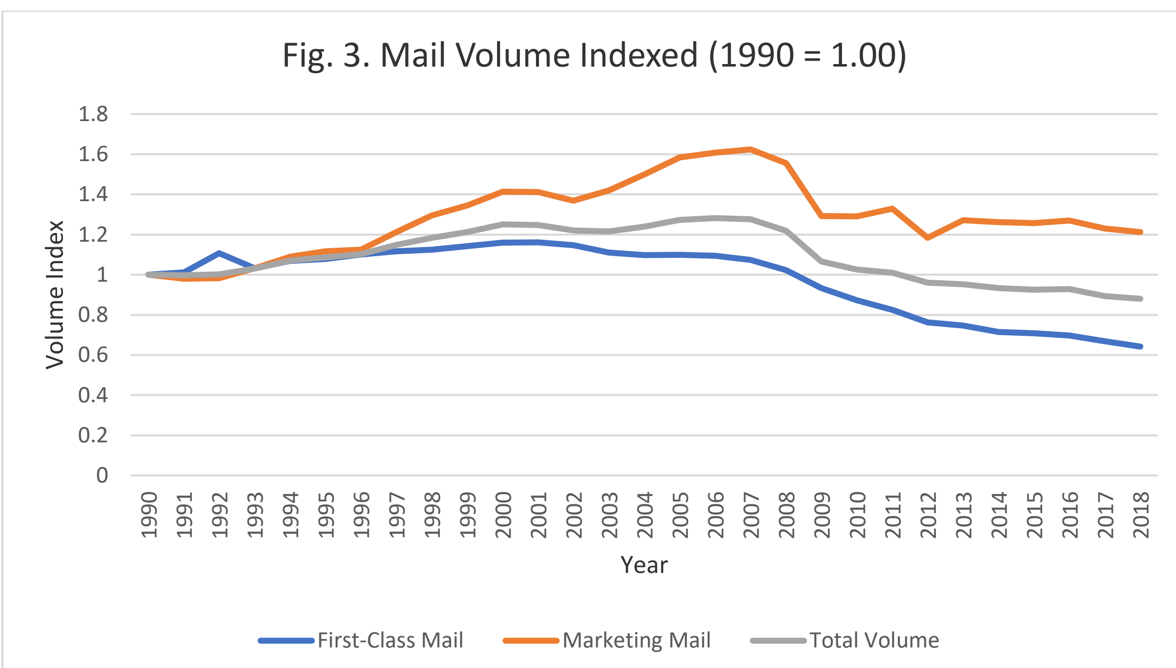


Fig. 3. Mail Volume Indexed (1990 = 1.00)

The impact of the recession on mail volumes was undeniable, but the larger, obviously more persistent threat, is from alternatives to the mail. Notwithstanding the beneficial impact of major package growth, no one expects mail volume to return to 200 billion, or perhaps even 150 billion, piece levels. Most observers believe that First Class Mail will continue steadily eroding, and Marketing Mail will be challenged just to maintain its volumes. While still hopeful about the additional potential of packages, that hope is leavened with concern about tightening competition in that fast-growing market.

The Severe Decline in Mail is Notwithstanding a Very Successful Public-Private Partnership.

The Postal Service would be in much worse financial shape, with even larger declines in volume than the 31% drop it has experienced since PAEA was enacted, were it not for its partnership with private sector businesses through the “workshare” program. Mail would have had a much smaller base from which to lose volume to competing electronic and hard delivery options. Workshare was first implemented in the early 1970s when USPS and the mailing industry established a set of postage discounts that incentivized and rewarded the private sector for performing work that reduced USPS’ costs. Virtually all increases in mail from the early ‘70s through the early 2000s came from worksharing.

Workshare activities include sorting mail, barcoding mail, making it compatible with USPS’ automated processing equipment, providing data that enables USPS to track each mailpiece and package through to delivery, and transporting mail closer to the destination postal facility. Because workshare activities reduce the USPS’ processing and transportation costs of handling mail, the Postal Service is able to pass some of that cost savings back in the form of postage discounts, which helps keep mail prices affordable. These discounts are priced to reflect as closely as possible no more than 100% of the USPS savings from outsourcing this preparation. The goal was to achieve the “lowest combined cost.” In addition, presorted mail moves through the postal network faster by “skipping” postal mail processing functions which enables the Postal Service to meet and exceed its delivery service standards and provides a better and more predictive service experience to users of the mail.

Package delivery services have long been a model for worksharing. Private sector shippers, integrators, and consolidators partner with the Postal Service to collect, process, and transport packages. They then hand them off to the Postal Service for “last mile” delivery often at the destination post office. In exchange, they receive discounted prices rewarding them for the work that would otherwise be done by the Postal Service. The 2006 PAEA split the mail and packages system into the old monopoly classes of mail (Market Dominant), and a Competitive category for packages and other products that already competed with the private sector. There, through a number of innovations, including Negotiated Service Agreements (essentially contracts for shipping packages), USPS became very competitive and has vastly grown its package volume. (See Topic 3 - page 10 - in this Primer.) While NSAs are also available for Market Dominant products, they are rare; in packages, they are frequent and virtually routine.

Since the 1970s, the workshare program has grown significantly and has saved USPS major costs. Workshare also was responsible for the tremendous growth of mail volume from the 1970s until the advent of mobile communications and then the Great Recession when the amount of mail significantly declined, and the decline has continued to worsen since. An entire mailing supply chain industry was formed around this public-private partnership.

The benefits of the workshare public-private partnership go beyond cost reductions for the Postal Service. The workshare model keeps mail affordable and improves service for all users of the mail which has helped slow the decline in mail. The industry is more than convinced that absent the public-private "workshare" partnership over the last decade, the reduction in mail volume in the U.S. would have been significantly higher resulting in even greater financial pressures on the Postal Service.

Expansion of the public-private partnership mentioned in the Task Force recommendations is critical to the future success and financial stability of the Postal Service. It would help the Postal Service, for example, to exploit one of its core strengths – its last-mile delivery network. And there are a number of other ways building on this public-private partnership can aid USPS regain financial stability and continue to serve the public.

Implications from the Loss of Revenue

Without sustained volume growth, the Postal Service cannot generate sufficient revenues to cover its costs, as it experiences cost pressures from a constantly expanding delivery network as new business and residential addresses proliferate, and the additional labor intensiveness of handling packages. It has a price cap set at CPI-U on its market-dominant products (still some 65% of revenues), which ties price increases to the growth in inflation. The cap is qualified only by a provision allowing the USPS to seek a price increase above it – known as an exigent rate increase – for an "extraordinary or exceptional" circumstance. That option was taken in 2013, when the Postal Regulatory Commission approved an "exigency surcharge," that recovered some $4.2 billion in revenues lost due to the recession. USPS also has availed itself of the maximum annual capped rate increase every year since 2008, except for 2009, and has also increased prices on its packages.

Why is there a price cap, anyway?

It's important to understand why there is a price cap in the first place. Prior to PAEA, USPS followed a rough three-year pricing approach: make money the first year, break even the second and lose money in the third – followed by another price increase. And the increases proposed were almost always sharply higher. Built into that cycle was much uncertainty and unpredictability of pricing, i.e., how much for each class and category of mail, including not always following that cycle. Plus, under the previous approach there was an administrative quasi-judicial process that proved extremely time-consuming and expensive. Having an annual price cap afforded USPS a much easier and faster path to increases, while providing the business community with the predictability and certainty on pricing it needed. And both sides, not to mention other "rate case" intervenors, such as postal unions or competitors, saved vast litigation expenses.

USPS has focused intensely on continued cost cutting; it claims a cumulative annual savings of some $15 billion. There has also been considerable focus on innovation. New tools such as informed visibility and informed delivery offer promise for real revenue growth that has not yet been realized. Also, USPS has engaged in successful promotions for the last several years that have boosted volume. The Postal Service will continue to roll out new products and services, but must do so without cannibalizing existing ones.

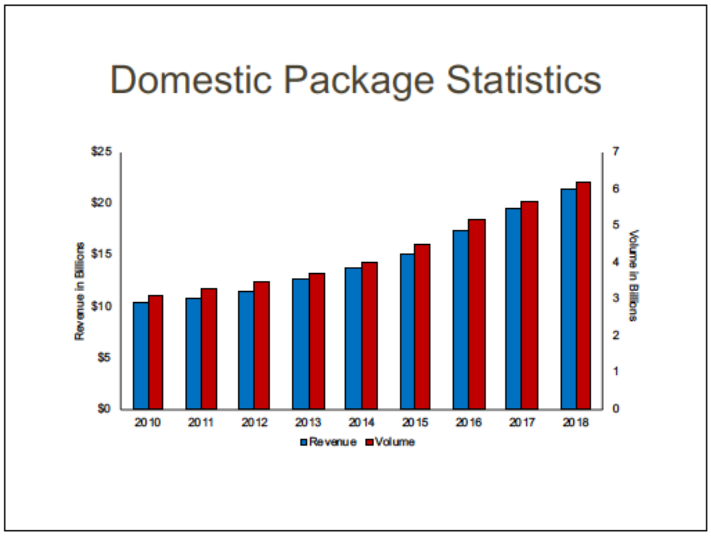
The Presidential Commission cited earlier cogently observed that:

> "Without significant modernization, the Postal Service will have three choices: dramatically roll back service, seek a rate increase of unprecedented scale, or fall even further into debt, potentially requiring a significant taxpayer bailout. Clearly, the public interest is better served by a strategy that aims instead to root out the substantial inefficiencies and other unnecessary costs apparent throughout the institution today in order to produce a far more efficient and capable 21st century Postal Service."

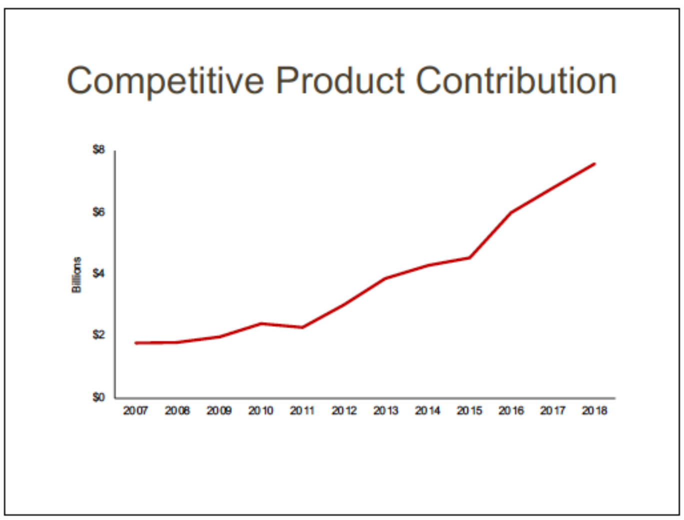
That assessment proved prophetic.

TOPIC 3: EXPANSION OF PACKAGE DELIVERY SERVICES

Since 2006 postal reform law freed it to fully compete, and price its package delivery services to market, Postal Service package delivery volumes and revenues have grown significantly.



Importantly, the contribution or package service to common network costs (overhead) has also exploded to more than $7 billion. These are costs that would have to be charged to other mail if the Postal Service did not deliver packages. They would not go away.

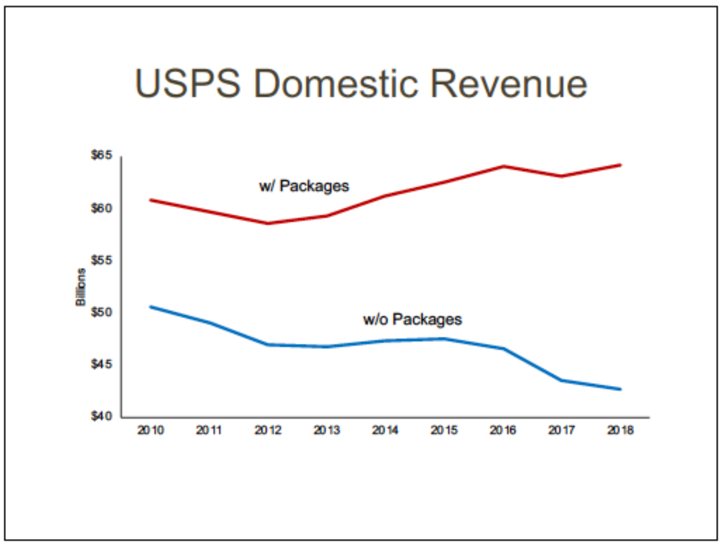


Postal Service package delivery services present a clear success story helping mailers, recipients, and the Postal Service itself. Without the substantial contribution of package services, the Postal Service's FY 2018 loss would have been $7.6 billion more.

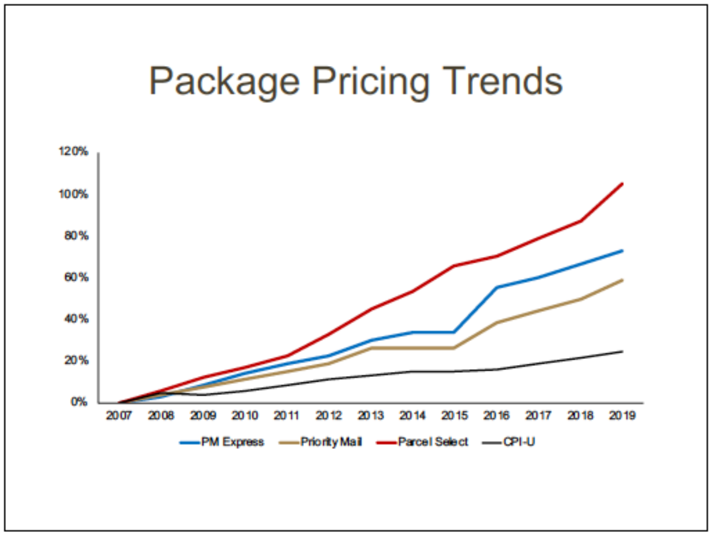
Table 1. POSTAL SERVICE FY 2018 Profit & Loss Analysis

($ Billions)	Actual	w/o Competitive Products
Revenue	$70.8	$47.7
Expenses	$74.7	$59.2
Net Profit / (Loss)	($3.9)	($11.5)
Source: Docket No. ACR2018, POSTAL SERVICE-FY18-1		

And domestic USPS revenue would plummet.



Contrary to the assertions of some critics, it is the package business that more and more supports the mail system. The eCommerce boom, increased worksharing, enhanced visibility (tracking), and reliable delivery enabled the USPS to increase its package prices at rates far exceeding inflation and often exceeding increases from competitors.



The future of universal, reliable, and affordable mail service depends on USPS success in the package delivery business. And that depends upon the Postal Service remaining truly competitive, as its Competitive products were meant to be. While there is an enormous and still growing proliferation of packages across the nation, the business of their delivery is highly competitive and growing more so as sufficient density to deliver packages with profit radiates outward from heavily-populated cities and suburbs. In other words, the Postal Service is hardly guaranteed to get the business, and it can easily price itself out of this lucrative and still heavily growing segment.

TOPIC 4: POSTAL SERVICE LABOR COSTS AND CONTRACTS

The Postal Service's total operating expenses in FY 2018 were $74.4 billion, of which compensation and benefits accounted for $56.9 billion, or about 76 percent. The Postal Service has reduced significantly the number of employees and overall amount of work hours it uses to process and deliver mail over the past decade. It also has made good use of labor contract innovations which permit a second tier of new hires at more economical rates, which can include conversions from non-career to career positions. Yet this combination has barely moved the needle on labor costs as a percentage of total costs. They have remained in the range of 75 - 80 percent of total operating costs for the past 35 years, despite major investment in automation equipment, incorporation of digital processes deeply into its structure, consolidation of processing plants and delivery routes, and more.

Work hours are the hours that postal employees spend on the job sorting, processing, transporting and delivering the mail. Since 2000, the Postal Service has stepped up its efforts to reduce the number of work hours it needs to accomplish these tasks while maintaining high levels of service. This savings is reflected in the fact that USPS now employs about 300,000 fewer career personnel than at its peak, albeit while also employing 137,000 non-career. As its mail volumes decline, the USPS would appear to need fewer work hours to get the job done, but it is a more complicated story. Packages are more labor intensive than mail, and the number of delivery points, as noted, continues to rise. Both of these factors have been contributors to some upward pressure on work hours – approximately 12 million - and employment generally over the past two years.

Annual Compensation Costs

Despite the enormous decline in employees and work hours and the ensuing cost reductions, the Postal Service still lost $3.9 billion in 2018. In addition, its labor costs remain stubbornly at 76 percent of its total costs. (The amount of labor costs for UPS and FedEx is closer to 50 percent of total costs.) The average annual compensation of a postal employee is roughly $75,000, when all compensation costs -- including workers compensation, overtime and benefits -- are factored in. When the cost of the retiree health benefits is factored in, average employee compensation jumps to about $79,000. See table below.

Compensation and Benefits Annual Costs
FY 2018

Total Workhours	1,169.6 million	
		Hourly
Total Compensation & Benefits (Millions)	$50,004	
Comp. & Ben. Per Workhour		$46.5843
Retiree Health Benefits (Millions)	$ 4.481	

Source: USPS 10-K report.

The Postal Service does not have many of the same tools that private industry has to reduce the number of employees when business conditions warrant. The Postal Service generally must rely on attrition to reduce the number of workers on its payroll. Labor contracts with its four unions do not allow the Postal Service to lay off workers who have more than six years of employment. Because of work rules, it also lacks significant flexibility to adjust the work force to work flows, in processing, retail or elsewhere. Nonetheless, in today's circumstances, those kinds of flexibilities are more of an academic discussion. USPS and its unions have made major progress in allowing the Service to sculpt and reduce its work force. And the results show, notwithstanding some heavy counterpressures, as mentioned previously.

Contract Requirements

The wages and benefits the USPS pays its unionized employees and the conditions of employment are set out in the contracts that the Postal Service negotiates with its unionized workforce. Four unions represent craft workers, covering close to 500,000 employees. Each union negotiates its own contract with the Postal Service through collective bargaining, which has been in place since 1970. The collective bargaining process is codified in Section 1003 of Title 39, United States Code, which states, "It shall be the policy of the Postal Service to maintain compensation and benefits for all officers and employees on a standard of comparability to the compensation and benefits paid for comparable levels of work in the private sector of the economy."

Negotiations for a contract usually begin about six months before the contract is set to expire. When the Postal Service and a union cannot reach agreement on a contract, the parties go to mediation. If they still cannot reach a resolution, they move to interest arbitration, which is a three-person panel chaired by a neutral arbitrator. This neutral arbitrator essentially decides the key elements of a Postal Service-union contract, such as pay, benefit contributions, work rules and other items. The arbitrator is not required to take into account the current economic conditions or the Postal Service's financial situation.

The exact terms of each contract differ. For example, the National Rural Letter Carriers Association is the only union with a contract that ties workers' salaries to mail volume. Based on annual evaluations, the Postal Service determines if the mail volumes that its rural carriers deliver have increased or decreased, and thus the work performed each day is increasing or decreasing. Their routes and salaries are then adjusted accordingly.

However, all four contracts have a few significant common elements:

- Cost of living adjustments (COLAs) two times per year.
- Gradual wage increases over the term of contract.
- No lay off clauses for workers employed more than six years.
- Seniority – bidding on open jobs awarded to workers with most seniority.

- Work rules prohibiting work to move across crafts; e.g. a clerk cannot do the work normally assigned to a mail handler. This limits the flexibility of managers to either get work done or keep employees active for their eight-hour shifts.

A no lay-off provision for employees is virtually unheard of in the private sector. Even COLAs, which provide regular wage increases based on increases in the rate of inflation, have become something of a luxury in labor agreements. According to a report in *Southern Economic Journal*, 61 percent of union contracts had COLAs in 1976, but only 22 percent of contracts included COLAs in 1995, the last year for which the Bureau of Labor Statistics collected data on collective bargaining agreements. The percentage of labor contracts today with COLAs has undoubtedly declined from that 1995 level.

The chart below lists the four unions, the number of members and key dates in the contracting and negotiation process.

KEY DATES IN CONTRACT NEGOTIATIONS

Union	**No. of Employees Covered***	**Contract Expires**	**Status of Negotiations**
American Postal Workers Union (APWU)	220,000	Expired September 20, 2018	Impasse December 20, 2018; in interest arbitration
National Rural Letter Carriers Association (NRLCA)	114,050	Expired May 20, 2018	In negotiation
National Association of Letter Carriers (NALC)	213,000	September 20, 2019	Not known
National Postal Mail Handlers Union (NPMHU)	47,000	September 20, 2019	Not known

Sources: Union websites.

Postal Service workers also enjoy benefits similar to other federal workers. Employees hired after 1984 participate in the Federal Employment Retirement System and those hired before that date are in the Civil Service Retirement System. Employees participate in the Federal Employees Group Life Insurance (FEGLI) and Federal Employees Health Benefits (FEHB) programs. Coverage for postal workers is about the same as other federal agencies, but postal workers pay a smaller premium than other federal workers in most agencies.

The law directs the Postal Service to negotiate the contribution rates it pays for life insurance and health insurance for unionized employees. The Postal Service can change existing FEGLI and FEHB contribution rates through negotiations with its unions (for bargaining employees) and consultations with management associations (for non-bargaining employees). These changes could result in significant savings for the Postal Service because the Postal Service contributes 100 percent of Basic FEGLI coverage, while most Federal employees pay for this benefit. For health benefits, USPS's contribution rate is significantly higher for most employees than the rate other federal and quasi-federal government agencies pay.

TOPIC 5: POSTAL SERVICE RETIREE HEALTH BENEFITS FUND

When Congress was debating postal reform in the mid-2000s, it grew increasingly concerned that the Postal Service would not be able to finance the health benefits it had promised its retirees. Mail volume and revenues were projected to decline, meaning the Postal Service of the future would be smaller with fewer mailers (ratepayers) in the system to cover the costs of health benefits. But the number of retirees would be quite large.

Congress decided not to burden future ratepayers with the entire liability, because it deemed it unlikely that they would be able to fund all retiree health benefits. There simply would not be enough ratepayers still in the system to fund a potentially huge liability. So, Congress insisted that any final reform bill include a pre-funding plan to put aside money for this long-term liability.

The Postal Accountability and Enhancement Act (PAEA) of 2006 ordered the Postal Service to make payments into a Retiree Health Benefits Fund to reduce the unfunded liability. However, the legislation set a payment schedule concerned with federal budget neutrality rather than actuarial practices. The end result was an overly aggressive payment schedule that resulted in mammoth USPS defaults on those payments – some $43 billion through FY 2018.

These sizable annual payments, along with the $2 billion or so the Postal Service paid each year as the employer's share of benefit premiums for current retirees, accounted for more than 10 percent of the Postal Service's total expenses. In 2017, the formula changed. From that point on the Postal Service had to make an amortized (over 40 years) payment to defray future liability, i.e., prefunding, and also pay "normal" costs of funding retirement health liability earned during the current year. While prefunding per se payments were cut in more than half, the normal cost pushed USPS annual retiree health obligations back toward very large, and still unaffordable, levels. As a result, USPS defaults continued into FYs 2017 and 2018. These payments, required of no other entity (many pay into their funds in those years when they believe they can afford it), have led not only to these defaults and functional insolvency, but they are the difference between the Service's being in the black or the red for the past six years.

PAEA Costs Related to Retiree Health Benefits (Dollars in Billions)

Year	Scheduled Payments to RHBF	Premium Payments	Total
2009	$1.4*	$2.0	$3.4
2010	$5.5	$2.3	$7.5
2011	$5.5	$2.6	$8.1
2012	$5.6	$2.9	$8.5
2013	$5.6	$3.2	$8.8
2014	$5.7	$3.5	$9.2
2015	$5.7	$3.9	$9.6
2016	$5.8	$4.2	$10.0
2017	$1.0	$3.3	$4.3
2018	$0.8	$3.7	$4.5

Total	**$42.6**	**$31.6**	**$73.9**

Source: US Postal Service (Columns may not add due to rounding.)
**The scheduled payment for 2009 had been $5.4 billion. Congress passed legislation revising the payment just for 2009 to $1.4 billion.*

The Postal Service's long-term obligation for health benefits for current and future retirees began in 1971 and will extend at least 50 years into the future. Such short-term funding for such a long-term obligation is a departure from normal practices in both the private sector and the federal government. No other private or public entity is prefunding retiree health benefits at the aggressive pace required of the Postal Service.

New Method of Funding

The current method of payment is not based on actuarial requirements but was created to maintain budget neutrality with the passage of the Postal Accountability and Enhancement Act of 2006. Prior to that, the Postal Service used a pay-as-you-go method of funding retiree health benefits, known as accrual accounting. As an employee retired, the USPS would begin paying the employer's share of the benefit premium. This is a generally accepted accounting principle and it is the way most companies and government agencies in the United States fund their retiree health benefits.

The Postal Service Retiree Health Benefit Fund is in solid shape:

- It contains a balance of about $ 90 billion (including receivables), which, assuming a cost of $5 billion a year, would fund retiree benefits for the next 18 years.
- The Fund's balance will increase each year through the payment of amortized and normal costs.
- The Postal Service made its first payment in FY 2007 of $5.4 billion and, with the assistance of borrowing until it hit its statutory debt ceiling, and a one-year reduction of its amount due in 2009, it made required payments through 2011, and has defaulted since. The Fund was initially funded with the calculated amount that the Postal Service had already over-funded its Civil Service Retirement System account ($17.1 billion) and an escrow payment of about $3 billion in FY 2006.

An additional problem is the Treasury Department limits investment of these funds to Treasury instruments. These return a low rate of interest; 2 – 3% currently. When outlays are growing at least 4-5% annually, more liberal investing should be permitted under strict oversight and safeguards. The best example of this would be a Thrift Savings Plan (TSP) – like approach, which could up the return to the neighborhood of 7%. That approach, already used widely in the federal government on individual employee accounts, and on an enterprise account basis for federal entities such as Amtrak, the Railroad Retirement Board, and TVA, would enable USPS vastly more flexibility (and hope) of meeting its obligations over time. Had the funds been so invested, instead of in Treasuries, then notwithstanding the worst recession in 80 years, today the Retiree Health Benefits Fund would contain some $10 billion more than it does.

A revised calculation of this obligation is essential, including "vested" liability.

PAEA took a one-size-fits-all approach in forecasting liabilities over seventy-five years. Prefunding amounts should be recalculated to take into account the Postal Service's current workforce, and reasonable projections for the future size of that workforce as well as a more nuanced calculus of how long workers will remain with the system.

As part of this, the Postal Service, asked to run like a business, should follow industry best practices on retiree health prefunding. In making the liability calculations on this, private sector companies follow applicable FASB rules, in this case Financial Accounting Standard 158. That rule requires that plan overfunding be reported as an asset and plan underfunding as a liability. The Postal Service liability would effectively be calculated as what it would owe were it to go out of business tomorrow. That liability would apply only to those persons "vested" in the retiree health plans. And that would generally cover retirees and those employees within five years of retirement eligibility.

TOPIC 6: STATUTORY LIMITATIONS ON DEBT AND USPS INCLUSION IN THE UNIFIED FEDERAL BUDGET

The Postal Service is expected by law to pay for its operations from revenues generated by the sale of postage and other fees associated with its products and services. This past year, however, USPS experienced a $3.9 billion net loss.

The postal law places a statutory limit on the net annual increases in debt the Postal Service can incur at $3 billion per fiscal year. It also limits total outstanding debt to $15 billion. As of the end of FY 2018, the Postal Service had $13.2 billion in outstanding debt. It had reached the statutory cap previously. And for the six years in which it was at the cap, and for 2018, it defaulted on its required payments to the Postal Service Retiree Health Benefits Fund.

A Return to GAO High-Risk List

The Government Accountability Office cited increasing debt levels, mounting losses and overall inability to cut costs fast enough to offset declining volumes as its reasons for putting the Postal Service on its high-risk list. The problems feed on each other and have produced a serious liquidity problem for the Service. As volumes decline, revenues plummet, and cost-cutting -- even though aggressive -- cannot keep pace. This necessitates, as indicated above, finding a bridge to fund its payroll and other operating expenses, as well as steep statutorily imposed contributions

Substantial Debt Load

It has been 13 years since the Postal Service was debt free. It ended fiscal year 2005 with a net income of $1.4 billion, then-record volumes of 212 billion pieces and zero debt. Since 2009, however, it has never supported less than $10 billion in debt; and in six of those ten years its debt has been at the statutory limit:

FISCAL YEAR	YEAR-END DEBT (millions)
2018	$13,200
2017	$15,000
2016	$15,000
2015	$15,000
2014	$15,000
2013	$15,000
2012	$15,000
2011	$13,000
2010	$12,000
2009	$10,200

Situations which might have improved the financial outlook did not do so. Public Law 108-18, which changed the Postal Service's Civil Service Retirement System contribution formula to its advantage, also mandated putting the savings in an escrow account and treating them as an expense – which had to be recovered from ratepayers. The 2006 PAEA legislation required the escrowed funds to be paid into the Retiree Health Benefits Fund. And, as explained earlier, PAEA also established a rigorous retiree health benefits prefunding schedule, actuarially unfounded but responding to Federal unified budget "scoring" concerns.[3]

Off Budget but Included in Federal Unified Budget

In the Omnibus Budget Reconciliation Act of 1989, the Postal Service won a hard-fought legislative battle to put its funding permanently "off budget." That is, the Postal Service is not included in the budget that the president sends to Congress every year. Congress agreed that mail delivery was a self-financing business whose operations should not be scaled up or down depending on national budget considerations.

"Despite its off-budget status, however, the Postal Service is still caught up in budget scoring decisions that erode its finances and obstruct its legislative program in Congress," the OIG said.

This is primarily because the Postal Service's revenues and expenses remain part of the "unified budget," which is the measure most commonly used for calculating budget effects. Further, the Postal Service's contributions for its retiree obligations are held in on-budget accounts, and as a result, reductions in payments for these obligations have a negative effect on the federal deficit because of the scoring process. Finally, the Postal Service receives a small on-budget appropriation to subsidize mail for the blind and overseas voters.

The Postal Service Fund, which is the fund in the Treasury for the deposit of all revenues, interest, appropriations, proceeds from borrowing, or any other receipts from Postal Service operations, is not included in the budget the president sends to Congress every year. It is, however, included in this broad economic concept called the "unified federal budget" that captures all government transactions with the public. Both the Office of Management and Budget and the Congressional Budget Office concentrate their attention on scoring changes to the *unified federal budget*, primarily because it allows large surpluses in the Social Security Trust Funds to offset deficit spending elsewhere in government.

"The Postal Service is an inadvertent victim of this strategy," the OIG said.

[3] For which, see USPS Office of the Inspector General, *Federal Budget Treatment of the Postal Service* (ESS-WP-09-001) (August 2009).

TOPIC 7: LARGE POSTAL NETWORK AND RETAIL PRESENCE

The Postal Service has almost 35,000 retail postal facilities, which includes post offices, post office branches and stations, community post offices, village post offices, and contract postal units. It also has about 600 mail processing facilities, which do not necessarily house retail operations, but where mail is sorted and processed for delivery. (See the chart at end of this section for a definition of each type of postal facility.)

In addition, the Government Accountability Office reported that customers could access stamps and postal services at 71,555 grocery stores, retail outlets and self-serve kiosks. (The Postal Service earned about 25 percent of its retail revenue through these retail outlets.)

Former Postmaster General John E. Potter put this huge retail presence in perspective when he said the Postal Service's retail network has more locations than Starbucks, McDonald's and Wal-Mart combined. Unlike these private sector entities, however, the Postal Service cannot, by law, close a post office solely because it loses money. It must notify the affected public and hold a 60-day comment period prior to closing a post office.[4] Should it decide to close a post office, the public has 30 days to appeal the decision to the Postal Regulatory Commission (39 U.S.C. 404(d)(1)). During this public comment period, postal officials often face political pressure from Members of Congress to keep the affected post office open.

The Postal Service has a separate process for closing other retail facilities. This can cause confusion in the general public, which often does not differentiate between a post office and other retail postal outlets. In the mind of the public, any place that sells stamps is often referred to as the "post office."

Federal law also directs the Postal Service to arrange its delivery and service network to most efficiently serve the public. This provision in the law can at times appear to be in conflict with the post office closing language. For example, the Postal Service has lost 67 billion pieces of mail since 2006. Some of it is due to the recession, but the decline is also a clear indication that Americans' mailing habits and patterns are changing for good. When businesses see such dramatic declines in sales and revenues, they close stores or consolidate operations. Most businesses, however, have nothing comparable to the Postal Service's legal obligation to serve "all areas" and "all communities" (39 USC sec. 101(a)). Thus, in the past three years, the Postal Service has closed just 157 post offices and only 330 total retail facilities.

[4] In deciding whether to close a post office, the USPS must consider:
(i) the effect of such closing or consolidation on the community served by such post office;
(ii) the effect of such closing or consolidation on employees of the Postal Service employed at such office;
(iii) whether such closing or consolidation is consistent with the policy of the Government ...that the Postal Service shall provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns where post offices are not self-sustaining;
(iv) the economic savings to the Postal Service resulting from such closing or consolidation; and
(v) such other factors as the Postal Service determines are necessary (39 U.S.C. 404(d)(2)(A)).

Retail and Delivery Facilities	2018	2017	2016	2015
USPS-managed				
Post offices	26,365	26,410	26,611	26,669
Branches, stations, carrier annexes	4,959	4.967	4,974	4,991
Subtotal	31,324	31,377	31,585	31,606
Non-USPS-managed				
Contract Postal Units	2,240	2,331	2,458	2,504
Village Post Offices	743	821	877	560
Community Post Offices	465	476	503	536
Subtotal	3,448	3,628	3,838	3,600
Total	34,772	35,005	35,423	35,206

Source: U.S. Postal Service Annual Reports

The Postal Service first studied about 3,650 retail facilities for closing, in the Retail Access Optimization Initiative (RAOI). It was then persuaded, instead, to match service offerings to workload by focusing on hours of operation rather than outright closings. The result became Post Office Structure Plan (POStPlan). This involved reducing service hours at some 13,000 facilities, while retaining the facilities themselves and offering the same services through them. In its advisory opinion, the PRC endorsed POStPlan.

Different Process for Mail Processing Facilities

Finally, the Postal Service has yet another process for closing or consolidating its mail processing facilities, which are plants that process large volumes of mail for transportation to delivery units. Many of the Postal Service’s large centralized processing facilities were built more than 30 years ago to handle a different type and amount of mail. In addition, the growth of worksharing over the past few decades has encouraged mailers to enter mail closer to destination, bypassing the centralized facilities. The Postal Service has sought to “rightsize” its network to better match its facility needs with the changes in mail volume and mailing patterns, often meeting political resistance in the process

For processing facilities, the Postal Service conducts Area Mail Processing (AMP) studies to determine if its efficiency and productivity could be improved by transferring operations to other facilities. The AMP process can take up to a year because it includes feasibility studies, briefings with the Board of Governors, ongoing communications with stakeholders and public meetings with affected communities. The Postal Service says the AMP process centralizes mail processing operations to better use resources, such as space, staffing and processing equipment and transportation. AMP is the backbone of the Postal Service’s network rationalization plan, which seeks to reduce costs and improve efficiencies and productivity.

Information on AMP projects is posted at https://about.usps.com/streamlining-operations/area-mail-processing.htm. As of June 2018, some 91 AMP studies were listed, in statuses from "Study Started" through "Approved" and "Implemented."

DEFINITIONS

The USPS administratively differentiates the types of retail postal facilities that conduct similar activities:

Main post office - The basic organizational unit of the USPS. Generally, each post office has primary responsibility for collection, delivery, and retail operations in a specific geographic area. [Also called post office.]

Post office branch - A unit of a main post office that is outside the corporate limits of the city or town of the main post office. [Also called classified branch.]

Post office station - A unit of a main post office that is within the corporate limits of the city or town of the main post office. [Also called classified station]. The USPS also provides postal services to customers through privately operated facilities:

Community post office - A contract postal unit that provides service in small communities where independent post offices have been discontinued. [It] bears its community's name and ZIP Code as part of a recognized address.

Village post office. A contract postal unit, similar to a community post office, but which provides only a limited range of postal services.

Contract postal unit - A postal unit that is a subordinate unit within the service area of a main post office. It is usually located in a store or place of business and is operated by a contractor who accepts mail from the public, sells postage and supplies, and provides selected special services (for example, postal money order or registered mail).

Mail Processing Facilities:

Network Distribution Centers (NDCs) were formerly known as bulk mail centers, but the USPS changed the name to better reflect the new functions of these 21 centrally located facilities. The centers operate more like processing and distribution centers, with specific dispatch times for mail to flow to other centers or facilities in the network.

Processing and Distribution Centers (P&DCs) perform originating and destinating processing for their own service areas. There are about 180 P&DCs, which exchange mail directly with other P&DCs as well as to their own subordinate P&DFs (if they have any) and delivery units.

Sectional Center Facility (SCF) is an older organization term that describes a mail processing facility serving originating or destinating mail in a single or multiple 3-digit ZIP Code area. SCFs can be P&DC or P&DFs. There are approximately 470 SCFs.

A **Processing and Distribution Facility (P&DF)** is smaller than a P&DC yet will generally perform similar outgoing and incoming distribution activities for all mail coming from and going to all delivery units. There are about 89 P&DFs.

Airport Mail Center/Airport Mail Facility (AMC/AMF) is a postal facility at an airport that receives, concentrates, transfers, dispatches and distributes mail transported by air.

TOPIC 8: CHANGING THE NUMBER OF DELIVERY AND PROCESSING DAYS

The Postal Service at one time considered a reduction in the number of delivery days from the current six days to five as a way to cut costs. It said the reduction would save it $3.1 billion a year. As a material nationwide change in the nature of service, this required an advisory opinion from the Postal Regulatory Commission (39 U.S.C. § 3661). The PRC, after public hearings, found this estimate $1.4 billion too high, and concluded that the plan would delay 25 percent of all First-Class and Priority Mail.

Mailing industry participants in the PRC hearing pointed out numerous flaws in the plan, stressing the likelihood of substantial losses of volume – a problem the PRC agreed was very significant and had been underestimated by the Service.

A later advisory opinion case involved "Mail Processing Network Rationalization" – a USPS plan to reduce the number of processing plants, necessitating reductions in service standards (notably, elimination of local overnight delivery for most First-Class Mail). Here again, the PRC found flaws in the plan and advised that most of the hoped-for savings could be achieved without changing service standards.

As a practical matter, the Postal Service needs congressional approval to change the number of delivery days because Congress includes language in the annual Postal Service appropriations bill that requires the USPS to deliver mail six days a week. This language has been included in the appropriations bills since 1983. And, each Congress regularly supports resolutions in favor of 6-day delivery with substantial, bipartisan, majorities.

Moreover, spurred by both business demands in the ecommerce sector, and consumer expectations of extremely rapid delivery of packages, the Postal Service has been expanding to a seventh day of delivery. Reducing delivery days is rapidly becoming an academic discussion.

TOPIC 9 – POSTAL GOVERNANCE

The Postal Service is ultimately governed by an eleven-member Board of Governors, which includes nine Presidentially-appointed, Senate-confirmed members and the Postmaster and Deputy Postmaster Generals. The Board is tasked with overseeing the powers of the USPS, directing and controlling its expenditures and capital investments, providing long-term strategic guidance, approving USPS officer compensation, labor agreements, capital expenditures, setting policies on postal matters and much more. Certain powers are reserved just to the appointed Governors, including hiring and firing the Postmaster General, and approving price and classification changes.

In 2006, the Postal Accountability & Enhancement Act (PAEA) reduced the terms of Governors from 9 to 7 years, as well as added professional qualifications. According to the PAEA, "[t]hey shall be chosen solely based on their experience in the field of public service, law or accounting. However, at least four of the governors shall be chosen solely based on their demonstrated ability in managing organizations or corporations (in either the public or private sector) that employ at least 50,000 employees." PAEA also said that the Governors "are chosen to represent the public interest generally and cannot be representatives of special interests. Not more than five of the nine may belong to the same political party."

Prior to the appointment and confirmation of the two current Governors in 2018, there had been no appointed Governors on the Board since 2016. Prior to the departure of the last appointed Governor, the Board formed a Temporary Emergency Committee (TEC) which included the Postmaster General and Deputy Postmaster General, and authorized it to be able to perform some functions of the Board. This TEC will remain in place until the Board is again able to assemble a quorum. A quorum consists of six members of the Board, so the TEC continues to function and will until another two Board members are confirmed.

Later in 2018, the President nominated two more individuals for Governor positions, who have been vetted and were accorded a Senate confirmation hearing on April 2, 2019. The President nominated another individual for Governor in March 2019.

A full complement of qualified and engaged Governors is essential to establishing and maintaining the strategic direction of the Postal Service. Even though the Postal Service was able to continue to operate from 2016-2018 with all nine Governor positions vacant, the lack of a Board took its toll and the USPS was fast approaching circumstances where it would not have been able to change prices, for example, without Governors in place. Prior to losing the last Governor, some rate changes were approved over the ensuing two years.

Beyond needing Governors to conduct its essential business practices, the Postal Service is facing significant changes in the "mail mix" of its products, as well as significant financial challenges, and needs the strategic oversight that only a qualified and diverse Board can provide. Competition for "last mile" delivery of parcels is increasing as innovation and technology rapidly advance solutions, and sufficient density of package delivery radiates further outward from cities and suburbs. Strategic vision and oversight are essential to guiding the USPS as it seeks to maintain and upgrade its world-class last-mile delivery network and focus on its core mission of serving the American public.

It is critical now more than ever that the private/public partnership between the mailing industry and the Postal Service, with the strategic guidance provided by its Board, collaborate even more deeply to reevaluate the mail supply chain with a view toward developing an even more updated and more cost effective, and mutually beneficial, mailing delivery platform. This can be one of the key tools to addressing the financial challenges and competitive threats the Service faces in its near- and longer-term future.

The Postal Service has done much to modernize and digitize its equipment and processes, but more must be accomplished. And the best way to achieve that is working closely with mail users and shippers to the end of serving their needs and encouraging their participation in mail and packages. This will buttress the system and enable to continue to execute its responsibilities to benefit the public and society as a whole, per the mission assigned by the Congress and the Constitution.

TOPIC 10: THE PRESIDENT'S TASK FORCE ON THE POSTAL SYSTEM

The Task Force, launched amid controversy in 2018, proved to be a beneficial exercise by dint of the light and attention it brought to the Postal Service's problems, and the inclusive way it went about its business, talking with numerous stakeholders. Its recommendations, however, range from helpful to decidedly counterproductive.

Among its helpful points, the first was that the Postal Service should continue its mission to bind the nation together, and deliver to all addresses. We believe that is vital to ensure that all Americans, including those in Rural America, receive still-vital mail and package services without discrimination or differentiation.

The second was a point the Task Force did not make. It did not recommend privatizing USPS. We agree. Privatization might very well balkanize the system, and quite likely render it unusable. Even if somehow sold or spun off in whole, the obstacles to success in the United States are daunting; profits without dramatic downsizing of the system and/or raising rates beyond affordability will be rather improbable to realize. Privatizations of foreign posts are simply not comparable or models for the United States. The differences in population, geography and volume of mail between the United States and, say, the United Kingdom and Finland, render comparisons virtually inapposite. And that is not to mention that privatizations overseas often took a decade or longer, with governments retaining legacy benefit costs, while prices go up and delivery goes down.

A further positive recommendation of the Task Force was that more outsourcing or worksharing make sense. Worksharing was a pivotal contributor to growing mail volume. It was responsible for virtually all mail volume growth subsequent to enactment of the Postal Reorganization Act, and still constitutes the vast majority of mail. The goal was to produce the "lowest combined cost," and benefit both the Postal Service and its customers. It worked. Thus, there may be additional opportunities to explore on this front, especially as technology develops further.

Third, the Task Force recommended restructuring USPS obligations, notably retiree health prefunding. We agree that retiree prefunding should be restructured to use postal demographic data, and apply only to retirees and vested employees (adopting private sector best practices under FAS 158). Beyond that, we submit that the balance of that obligation can and should be resolved through integrating the 20% or so of USPS annuitants who are not subscribed into Medicare. Each of these annuitants has paid his or her Medicare taxes over the years, while USPS has paid the employer share. Each is eligible to enroll in Medicare right now. Were they to do so on their own motion, Medicare would, by law, have to cover them. It is also possible that an offset can be devised for any Medicare expense but, given the above, under no circumstances would Medicare for any postal workers be accurately considered a "bail-out."

Finally, we agree with the Task Force that vacant Governors' positions must be filled. USPS has badly missed the outside director guidance that Presidentially-appointed, Senate-confirmed Governors were intended to, and do, give. We encourage the President to nominate additional qualified candidates, and for the Senate to move as swiftly as it can to complete their vetting and hearings.

There are also grave concerns about a number of the Task Force's recommendations. Dividing the system up into undefined "essential" and other streams of mail would be seriously counterproductive. While the Task Force took some pains to describe the differences it envisions generally, the bulk of this work would be delegated to the Postal Regulatory Commission. While we believe that the Commission does a generally excellent job of fulfilling its various statutory mandates, a restructuring this fundamental, with all the substantive, policy and political dimensional overlays to it, should be a job retained by Congress.

On the notion of separating mailstreams, it is puzzling, to say the least, how this would not adversely impact economies of scale and scope. At its simplest, would it mean two postal trucks would cover the same route? It would also confuse the public. What is essential? What is not? Can't you just put a stamp on something and send it First Class?

For business, the problems come in price and service. The Task Force recommended marketing and promotional mail be charged at market rates. What would "market rates" be for marketing mail? Undoubtedly higher, such rates would likely have a dramatic impact on mailings from major companies that continue in the mail because of the somewhat higher ROI of the mail "channel," in contrast with various online channels (email, social media, streaming, websites, etc.), as well as broadcast, cable and print. Raising prices degrades that ROI advantage.

That implicates the question of price elasticities. How much mail and packages would the Postal Service lose with sharply higher prices? Elasticities for the Postal Service used by both postal agencies relied upon by the Task Force are not only in part based on badly dated information, several decades worth, but are filled with trend analyses and other filler factors that impact accuracy. The simple fact is that USPS has raised rates at CPI-U since PAEA took effect, and so the predictive power of their elasticities for much larger increases is at best suspect.

The one exception to that, which itself was not nearly as high as "market rates" might turn out to be, the "exigent surcharge" imposed by the Commission to restore some of the revenues supposedly lost due to the Great Recession, does not change that calculus. Mailers report that they saw that increase as temporary and not worth retooling their marketing mixes among all the channels available. A permanent increase would be another matter.

The bottom line is that at this point price does matter. No longer as driven to alternatives to the mail by other factors such as novelty or convenience, ROI is now an even more central consideration. And when the price of mailing is raised, that ROI declines, making alternative channels more attractive, and costing USPS significant volume when it cannot afford to lose any more, let alone a substantial amount.

The same is true for package and parcel shipping. At their current pricing, which has been aggressively increased (some 65% over ten years) while volume for USPS has expanded by orders of magnitude, USPS competitive packages and parcels now provide nearly 25% of USPS overhead costs, some $7+ billion in 2018. This shipping volume due largely to the explosion in ecommerce has filled a significant part of the revenue gap created by the ongoing deflation of First Class Mail volume and revenues.

The surest way to kill the goose laying this golden postal revenue egg is to raise prices substantially. While USPS competitors are now encroaching on its volume because the density of package delivery has sufficiently increased in more jurisdictions to make their deliveries profitable, customers may turn to them, form their own delivery fleets, utilize Uber and other novel options, and otherwise divert from a USPS that would be noticeably less price-competitive.

Finally, the Task Force recommended USPS and the Commission embrace fully distributed costing (FDC) or other major cost reallocations. FDC has been rejected in academia, and in regulatory and judicial outcomes for generations. A major reason is that some costs cannot be accurately directly or indirectly attributed to any specific class of mail or product. For example, how would the salary of the Postmaster General be fully allocated? Or of a carrier who must conduct his/her route whether or not any mail or packages are delivered, or picked up. The same for the carrier's truck, fuel and maintenance. And so on. But under FDC, all those conventional overhead costs are arbitrarily distributed to all the products in the system, raising rates and reducing USPS flexibility to make general price determinations and specifically in Negotiated Service Agreements.

In short, the Task Force Recommendations are no panacea. They are a mixed bag of important, common sensical thoughts to help USPS, and other proposals that are puzzling at best and in need of much greater explication, but on their face stand little chance of helping the system.