

POSTAL TRENDWATCH

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Postal TrendWatch
Q4FY09

Q4 09: USPS Posts Third Consecutive Annual Loss

Executive Summary

The United States Postal Service (USPS) concluded FY 2009 with a \$3.8-billion loss and a total cumulative debt of \$10.2 billion. This was its third consecutive year of multibillion-dollar losses. The loss would have been even bigger had Congress not intervened to permit USPS to delay \$4 billion in required payments to its retiree health-benefits fund. Both revenue and mail volume declined in 2009 compared to 2008.

At the dawn of FY 2010, USPS is considering closures of under-utilized facilities and is proceeding with the full-scale rollout of its Flats Sequencing System to automate the processing of flat mail. The Service is also petitioning Congress for the right to cut delivery to five days a week and to offer non-postal products.



Economic Downturn Leads to Decreased Volume and Revenue

Overall, mail volume fell 12.7 percent in FY 2009, to 177.1 billion pieces, and revenue declined 9.1 percent, to \$68.1 billion. Postal Service officials attributed the declines in revenue and volume to the negative economic climate. According to the FY 2009 10-K report, the Service predicts a decline in mail volume of 10-15 billion pieces next year.

First Class Mail revenue dropped by \$2.3 billion in FY 2009 compared to FY 2008. First Class volume declined nearly 8 billion pieces.

The story was similar for Standard Mail. Revenue in this class fell \$3.2 billion in FY 2009. Standard Mail volume plummeted by 16.4 billion pieces. USPS leaders predict advertising mail volumes will begin to increase toward previous levels as the economy improves. "The Postal Service product mix is shifting away from transactions, correspondence, and periodicals mail toward advertising and shipping services which are highly correlated with economic expansions and contractions," explains the 10-K report.

Post Office Closures Around the Country Discussed

In light of declining mail volume and significant monetary losses, USPS is looking to close postal facilities around the country as part of the Station and Branch Optimization and Consolidation (SBOC) Initiative. On July 2, 2009, the Postal Service announced to the Postal Regulatory Commission (PRC) that it was examining 3,200 (and later 3,600) postal branches and stations, out of its total of over 36,000, as candidates for closure. Thanks to widespread pressure from Congress, postal labor unions, and the public, that list has been pruned to just 371 facilities as of October.

Postal regulators have expressed concern about the Postal Service's apparent preference for closing facilities most often used by consumers. In a recent C-SPAN interview, Goldway explained, "They've reduced a third of the collection boxes that people may have seen, and they've cut hours at post offices, and they are looking for other ways in which they can reduce service, sometimes to the detriment of consumers."

Meanwhile, the Postal Service maintains 599 processing facilities around the country, including 268 processing and distribution centers.

The PRC has embarked on a series of hearings throughout the country to discuss potential facilities closures. The purpose of these hearings, as articulated by PRC Chair Ruth Goldway at one such hearing in the Bronx, New York, is to provide "a critical forum for public input as the Postal Service seeks, under difficult circumstances, to find the right balance between service and cost control."

Jury Still Out on Impact of "Summer Sale"

The Standard Mail Volume Incentive Pricing Program, also known as the "Summer Sale," ran from July 1 to September 30. Eligible commercial mailers received a 30 percent rebate on all Standard Mail letters and flats above a certain volume threshold. The threshold varied from customer to customer and was based on the mail-usage habits of each mailer between 2008 and 2009.

As USPS explains, "if a mailer sent 1.1 million pieces between October, 2008 and March, 2009, compared to 1 million between October, 2007 and March, 2008, that mailer's threshold would be 10 percent above (1.1 million divided by 1 million) the volume sent between July 1, 2008, and September 30, 2008."

USPS initially projected that the increased usage

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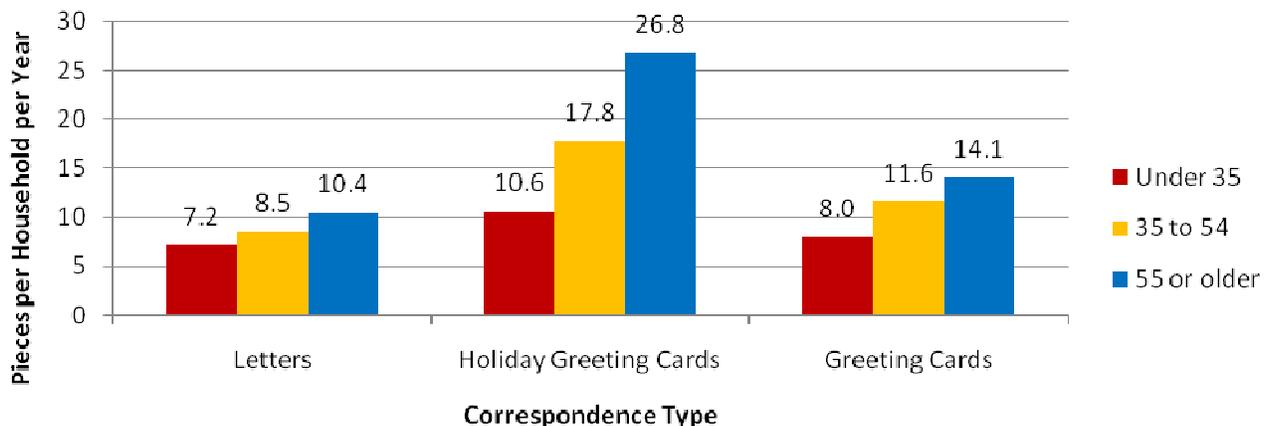
-- PRC Chair Ruth Goldway, on USPS Service Reductions

spurred by the program would result in between \$38 million and \$95 million in new revenue.

Postal expert Michael Schuyler of the Institute for Research on the Economics of Taxation applauded USPS for instituting the program. "The Sale brought in more revenue than the Service expected, encouraged use of core mail products, and aided customers," said Schuyler.

But sales alone will not close the hole in USPS's budget. "The Summer Sale's extra revenue, which was tiny compared to the Service's total revenue, highlights the fact that revenue enhancements, by themselves, can only slightly improve the Postal Service's bottom line," Schuyler concluded.

Trends: Personal Correspondence Sent by Age Group -- 2008



Source: *The Household Diary Study: Mail Use & Attitudes in FY 2008*

Deployment of Flat Sequencing System under Way

In an effort to streamline the sorting of flat-sized mail, USPS has begun deploying the much-anticipated Flats Sequencing System (FSS) around the country. FSS machines automatically sort flat mail into the proper delivery order, a task hitherto performed manually by postal employees.

With the number of delivery points growing each year, automating delivery point sequencing with the FSS is intended to cut costs. A similar, automated sorting system was implemented in the 1990s for letter mail. According to USPS, that system currently allows the Service to avoid annual costs of more than \$5 billion.

The FSS rollout was begun in December 2006 at an initial cost of \$1.4 billion. It's the largest current Postal Service mail automation investment. USPS expects to save \$599.5 million each year after the system is fully implemented.

Once the rollout is complete in August 2010, 42 sorting facilities around the nation will house 100 FSS machines.

Household Diary Study Reveals Mail Usage Trends

- In 2008, households received 148.6 billion pieces of mail and sent 21.3 billion pieces. Of that mail:
 - 16.5 billion pieces were correspondence.
 - 41.7 billion pieces were transactions.
 - 99.4 billion pieces were advertisements.
- Total correspondence by volume in 2008 fell 2.4 percent compared to the previous year.
- Between 2002 and 2008, correspondence has dropped a total of 14 percent.
- In 2008, households received 6.4 billion periodicals, down from 6.6 billion in 2007.
 - That's an average of less than one periodical per week per household.
 - Newspapers, which comprised 35 percent of total periodicals volume in 1987, comprise only 18 percent of total periodicals volume in 2008.

The USPS Office of Inspector General (OIG) released a report critical of existing FSS machine performance in September 2009. According to the OIG's report, "FSS machine performance [has] improved," but "the system failed to meet key [statement of work] performance parameters." As a result, the OIG said, "we believe deploying FSS machines to additional sites is premature." The OIG recommended that USPS "install and test only one additional Flats Sequencing System until the system demonstrates operational stability and successfully passes the field acceptance test."

Mail Volume Received by Internet Access and Income

Mail Received (Pieces per HH per week)	Households with Internet Access (Percent)	Median Annual HH Income
45 or more	94%	\$95,868
36-44	89%	\$77,928
30-35	89%	\$69,542
24-29	88%	\$66,751
18-23	76%	\$54,966
12-17	69%	\$44,730
Less than 12	54%	\$30,343

Source:
The Household Diary Study: Mail Use & Attitudes in FY 2008

Despite a Postal Bailout, USPS Remains Financially Unstable

USPS was granted a financial reprieve on September 30 when the Senate voted to allow the Postal Service to delay a scheduled payment of \$4 billion to the USPS retirees' healthcare fund. The House passed a similar provision on September 25.

Understanding this post office "bailout" as only a stop-gap solution to the service's financial problems, the Subcommittee on Federal Workforce, Postal Service and the District of Columbia of the House Oversight and Government Reform Committee held a hearing on November 5 to examine "Postal Service revenue-generation initiatives."

In his testimony, Robert Bernstock, USPS President of Mailing and Shipping Services, laid out a "four pronged effort to correct USPS finances." This strategy consisted of:

- 1) bringing down costs;
- 2) switching to a five-day delivery week and modifying retiree health benefits;
- 3) a renewed focus on revenue generation programs that are allowed within the current law;
- 4) amending the law to enable USPS to more easily generate revenue.

Among these proposals, the change to five-day delivery is the most controversial. Rep. Gerald E. Connolly (D-Va.) argued that "the ability of the Postal Service to deliver mail quickly on six days of the week . . . protects our constituents' quality of life."

USPS leaders have repeatedly suggested lowering costs through a curtailed delivery schedule for quite some time. During a hearing before the Senate in August, Postmaster General John Potter also argued for a shorter work week, on account of the fact that USPS "is delivering less mail to more addresses, resulting in less revenue per address served."

PMG Potter also argued at the hearing for the authority to begin offering non-postal products. "Other national postal administrations complement their traditional offerings with banking, cell phone, logistics and other services to generate the income necessary to offset the costs of their universal service obligation," said Potter. He continued, "We believe the time has come to allow the Postal Service to introduce new lines of business at its retail facilities."

The Postal Service's contracts with its two biggest labor unions expire in November 2010 and November 2011. With more than 85 percent of its full-time employees covered by collective bargaining agreements, the outcomes of these ongoing negotiations will have a major impact on the agency's bottom line in the coming decade.

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-- Michael Schuyler, Senior Economist, IRET

Prices for 2010

Postal officials will leave prices unchanged on "market-dominant products" in 2010 (namely First-Class and Standard Mail, periodicals and single-piece parcel post services).

But on October 15, USPS announced a series of price hikes for competitive products like Express, Priority, and International Mail. Effective January 4, the price of priority mail will increase by 3.3 percent, as will the average price of international mail. Express mail will be 4.5 percent more costly in 2010. Domestic priority mail flat-rate envelope will cost \$4.90, down from the current price of \$4.95.