

# Troubles at the Postal Service

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## Key Findings

- Americans rate the U.S. Postal Service more highly than most other federal agencies. Nevertheless, the Postal Service has serious problems.
- Although the agency's leadership has engineered a skillful and responsible downsizing, the government-owned enterprise continues losing billions of dollars yearly. Between 2007 and 2014, the Service lost \$51.7 billion.
- For the last three years, the Service has failed to make legally required payments to the U.S. Treasury. The Service indicates it will again default on the statutory obligations, which are for the Postal Service Retiree Health Benefit Fund, in 2015 and 2016.
- Even though the Service relaxed on-time delivery standards for First-Class and Periodical Mail at the start of 2015, the percentage of mail arriving late has increased dramatically this year.
- As the Service launches new initiatives in the areas of shipping and packages, there are concerns about whether the Postal Service is losing its focus on what, for public policy reasons and by statute, should be its number one priority: speedy and reliable letter mail delivery.
- As the Postal Service struggles financially, service reductions have been felt most acutely in rural communities, which are often highly dependent on mail service. If Congress decides to intervene, however, it should be mindful of the Service's precarious finances and not impose expensive new unfunded mandates.

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The U.S. Postal Service must be doing something right. A Gallup survey last November found that the Postal Service ranks first among 13 major government agencies. Seventy-two percent of respondents think the Service is doing a good job, and only 8 percent regard its performance as poor.<sup>1</sup> For comparison, the percent of people in the survey giving scores of poor to the Veterans Administration, Internal Revenue Service, and Environmental Protection Agency were 35 percent, 27 percent rate, and 20 percent, respectively.

The Service also deserves commendation because during the last decade and a half its leadership has moved skillfully to trim costs while, until very recently, maintaining a generally high level of service. Recognizing that technology and operational adjustments would allow the agency to function effectively with a much smaller workforce, Postmaster General John Potter and his executive team began to slim the workforce dramatically in 2001, almost entirely through attrition. When mail volume started plummeting in 2007 because of the Great Recession and an upsurge in Internet penetration, the management teams led by Mr. Potter and his successor, Postmaster General Patrick Donahoe, redoubled their efforts to rightsize the agency. The number of postal workers, which reached almost 906,000 (career and noncareer) at the end of the last century, had been pared to about 618,000 by the end of 2014.<sup>2</sup>

In many other respects, however, the Postal Service's recent performance is troubling. This paper outlines five areas of concern.

## Massive Losses

The Postal Service last earned a profit in 2006. Since then, its yearly losses have ranged from \$2.8 billion to \$15.9 billion.<sup>3</sup> Its cumulative losses over the period 2007-2014 total \$51.7 billion. There is no turnaround in sight. The Postal Service will almost certainly register another multibillion dollar loss in 2015; for the first two quarters of 2015, it suffered a net loss of \$2.8 billion.<sup>4</sup>

The Service moved from profits to large, chronic losses when mail volume plunged due to the combined effects of the Great Recession and heightened Internet penetration. After peaking in 2006 at 213.1 billion pieces, total Postal Service volume had fallen to 155.4 billion pieces by 2014, a drop of 27 percent.<sup>5</sup> On lucrative First-Class mail, which the Service prices sharply above cost, the decline from 2006 to 2014 was even steeper, at 35 percent.

1 Jeffrey M. Jones, *Americans' Ratings of CDC Down After Ebola Crisis*, GALLUP, Nov. 20, 2014, <http://www.gallup.com/poll/179522/americans-ratings-cdc-down-ebola-crisis.aspx>.

2 Postal Service, *Annual Report, 2014*, p. 68, <https://about.usps.com/publications/annual-report-comprehensive-statement-2014/annual-report-comprehensive-statement-2014.pdf>; and Postal Service, *Annual Report, 2001*, p. 45, <http://about.usps.com/who-we-are/financials/annual-reports/fy2001/contents.htm>. The number of workers is extremely important from a cost standpoint because about 80 percent of the Postal Service's expenses are labor related. In 2014, labor costs (including retiree health benefits and workers' compensation) were 78.2 percent of the Service's total operating expenses. See Postal Service, *Form 10-K, 2014*, Dec. 5, 2014, p. 13, <http://about.usps.com/who-we-are/financials/10k-reports/fy2014.pdf>. The years mentioned in this paper are fiscal years, which begin for the Postal Service on October 1 and end on September 30.

3 Postal Service, *Annual Reports and Form 10-Ks*, various issues.

4 Postal Service, *Form 10-Q, Quarter III, 2015*, Aug. 7, 2015, p. 3, <http://about.usps.com/who-we-are/financials/financial-conditions-results-reports/fy2015-q3.pdf>.

5 Postal Service, *A Decade of Facts and Figures*, 2015, <https://about.usps.com/who-we-are/postal-facts/decade-of-facts-and-figures.htm>.

The shift away from mail has meant that the Service can no longer count on revenue growth from one year to the next. Instead, revenue decreased sharply during the Great Recession and has been stagnant since.

When Congress passed the Postal Reorganization Act of 1970 (P.L. 91-375), which converted the old Post Office Department into the modern Postal Service, it directed that the government-owned enterprise be self-supporting in order to promote efficiency and reduce the drain on the U.S. Treasury. Congress reiterated those objectives when it enacted the last major postal reform, the Postal Accountability and Enhancement Act of 2006 (P.L. 109-435).

However, with the Service's recent losses now north of \$50 billion and climbing, achieving those goals looks increasingly elusive. Although the Postal Service has not yet received an explicit taxpayer bailout, it has failed to meet its legal obligations for several years in a row (discussed in the next section). The odds that a bailout will eventually become unavoidable increase as the sea of red ink continues rising.

Adding to concerns regarding a taxpayer bailout, the Postal Service has huge and mounting unfunded liabilities. The Government Accountability Office (GAO) examined five major unfunded liabilities and estimated they had grown by 62 percent between 2007 and 2013, from \$61.6 billion to \$99.8 billion.<sup>6</sup> Those liabilities will eventually have to be paid, either by the Postal Service from its revenues, which may mean sharp rate increases for future mail users, or by taxpayers. One of those liabilities is the Service's credit line at the U.S. Treasury, which it has maxed out at its statutory borrowing limit of \$15 billion. Given the Service's finances, it is doubtful that the enterprise will ever repay this money.

The losses would not have been as large if the Postal Service had more operational flexibility. While the Service does have greater operational discretion than many federal agencies, it has much less than a typical private-sector business because Congress often micromanages its actions. For instance, although the Service has wanted to move to five-day-a-week delivery since 2009, claiming it could save \$3.1 billion a year without seriously inconveniencing most mail users, Congress has consistently blocked that adjustment.<sup>7</sup> (The Postal Regulatory Commission estimated the saving would be \$1.7 billion annually, but that is still a considerable amount.<sup>8</sup>)

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6 Frank Todisco, Government Accountability Office, *Action Needed to Address Unfunded Benefit Liabilities*, GAO-14-398T, Mar. 13, 2014, p. 2, <http://www.gao.gov/assets/670/661637.pdf>.

7 John E. Potter, Postmaster General, *Statement*, before Subcommittee on Federal Financial Management, Government Information, Federal Services and International Security, Senate Committee on Homeland Security and Governmental Affairs, Jan. 28, 2009, [http://local300npmhu.org/USPS%20News\\_%20Statement%20of%20Postmaster%20General\\_CEO%20John%20E.%20Potter%20-%20January%2028,%20.pdf](http://local300npmhu.org/USPS%20News_%20Statement%20of%20Postmaster%20General_CEO%20John%20E.%20Potter%20-%20January%2028,%20.pdf). Since 1983, and continuing through the present, Congress has attached a rider to annual appropriations bills mandating six-day-a-week delivery.

8 Postal Regulatory Commission, *Advisory Opinion On Elimination Of Saturday Delivery*, Docket No. N2010-1, Mar. 24, 2011, [http://www.prc.gov/Docs/72/72327/Advisory\\_Opinion\\_032411.pdf](http://www.prc.gov/Docs/72/72327/Advisory_Opinion_032411.pdf).

This is a reminder that when market conditions change rapidly, state-owned enterprises tend to be less agile than private-sector businesses, even when the government enterprises quickly recognize the challenges, because they must often secure the approval of others in government before acting. On the other hand, state-owned enterprises often enjoy exemptions, immunities, and indirect subsidies that private firms could never obtain. For example, a few of the Postal Service's hidden subsidies include exemption from paying property taxes on the assets it owns, sales taxes on the goods and services it sells, and motor vehicle licensing and registration fees on its more than 210,000 vehicles. The Service does owe a 35 percent federal tax on income from its competitive-market products, but the law specifies that it pay the tax—to itself.<sup>9</sup> These benefits of being a government-sponsored enterprise have not prevented large deficits, and do not make up for the lack of flexibility due to Congressional interference.

## A Series of Defaults

The Postal Service promises its workers that they will receive generous health benefits in retirement. To provide a fund from which to pay those promised benefits, the Postal Service is required by law to make large annual contributions to the Retiree Health Benefit Fund (RHBF).

The Postal Accountability and Enhancement Act of 2006 established the RHBF and specified the payment schedule for the years 2007-2016.<sup>10</sup> The act also specified that the Office of Personnel Management (OPM) is to conduct an actuarial valuation in 2017 and, if further payments are needed, establish a long-term amortization schedule. Unfortunately, shortly after Congress enacted the legislation, with its statutory payment schedule through 2016, mail volume began spiraling downward due to the Great Recession and intensified electronic diversion. As a result, the Service has had difficulty making the required payments. In response, Congress provided temporary relief: it reduced the amount due in 2009 to \$1.4 billion,<sup>11</sup> and it postponed the \$5.5 billion payment originally due in 2011 until 2012.<sup>12</sup>

In 2012, however, the Service informed key members of Congress that it had only a few days of cash left in the till and could pay nothing into the RHBF that year.<sup>13</sup> It then defaulted on the \$11.1 billion it owed that year: the \$5.5 billion payment originally due in 2011 and the regular \$5.6 billion payment due in 2012. In 2013, again claiming insufficient liquidity, the Service defaulted on the \$5.6 billion payment required that year. In 2014, the enterprise defaulted once more, this time for \$5.7 billion. So far, the defaults total \$22.4 billion.

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9 Technically, the Service sends the check to the U.S. Postal Service Fund, which is a revolving fund at the U.S. Treasury that the Service essentially uses as a checking account. (See PAEA, sec. 402.)

10 P.L. 109-435, Title VIII.

11 P.L. 111-68.

12 A series of laws pushed the due date from 2011 into 2012. The last was P.L. 112-74.

13 For a brief summary of the events mentioned in this paragraph, see Postal Service, *Form 10-K, 2014*, op. cit., p. 60, Dec. 5, 2014, <http://about.usps.com/who-we-are/financials/10k-reports/fy2014.pdf>.

Moreover, the Postal Service declares that it intends to default on its legally required RHBF obligations in 2015 and 2016,<sup>14</sup> which would push its cumulative defaults to \$33.9 billion.

Since 2010, when the Postal Service closed the year with only \$1 billion of cash and cash equivalents on hand, its liquidity has been rising.<sup>15</sup> Its cash and cash equivalents stood at \$4.9 billion at the end of 2014,<sup>16</sup> and they reached \$8.4 billion at the end of the third quarter of 2015.<sup>17</sup>

In the private sector, liquidity varies widely from firm to firm, and it often fluctuates substantially over time for the same firm. In addition, healthy businesses normally have credit lines to tide them over if they encounter unexpected cash crunches. In contrast, the Postal Service has reached its borrowing limit. Nevertheless, comparisons with businesses having roughly the same revenue as the Service suggest the government enterprise's liquidity is no longer spectacularly low by private-sector standards. For example, Walgreens, Comcast, PepsiCo, and Pfizer held cash and cash equivalents of \$2.6 billion, \$3.9 billion, \$6.1 billion, and \$3.3 billion, respectively, at the end of 2014.<sup>18</sup>

Although the Service does not have sufficient cash to meet its RHBF obligations in full, its \$6.1 billion of cash and cash equivalents would seem to be enough for a partial payment. At this time, the Service's refusal to pay anything at all into the fund is not because it cannot do so but because it chooses not to do so. To be sure, the agency believes there are better ways to use the money, such as replacing its aging vehicle delivery fleet, but contributing to the fund is a legal requirement. If the Service were a private business, it is almost inconceivable that it could default on \$22.4 billion of government obligations, and intend to default on an additional \$11.5 billion by the end of 2016, without dire consequences, especially if it did not offer to submit even partial payments. So far, however, "no [monetary] penalties have been assessed."<sup>19</sup> Nor have there been any political penalties. (Many members of Congress apparently prefer the succession of defaults to the Service's running out of cash and needing an explicit taxpayer bailout, because the bailout would result in "budget scoring" against the federal deficit. Congress avoids this embarrassment by taking no action. Nonetheless, the loss to the Treasury is real.)

The RHBF has been heavily criticized on two fronts. One complaint is valid, but the other is not. The valid criticism is that the contribution schedule has proven too aggressive. The schedule seemed feasible when Congress enacted PAEA in 2006 because mail demand and postal revenue were then setting records. However, after mail demand plunged, Congress should have stretched out the funding schedule. It should not have stuck with the old schedule with only minor adjustments, which triggered the precedent-setting Postal Service defaults.

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14 For instance, the Service's latest quarterly financial report warns, "[G]iven its liquidity concerns, the Postal Service has and will likely continue to default on these prepayments..." (Postal Service, *Form 10-Q, Quarter III, 2015, op. cit.*, p. 11.)

15 Postal Service, *Form 10-K, 2014, op. cit.*, p. 13.

16 *Ibid.*

17 Postal Service, *Form 10-Q, Quarter III, 2015, op. cit.*, p. 4.

18 The corporate data was accessed on July 16, 2015 on Google Finance, <https://www.google.com/finance>. All years are the companies' fiscal years.

19 Postal Service, *Form 10-K, 2014, op. cit.*, p. 60.

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The second objection is to the very idea of funding expenses that are incurred now but have not yet come due. According to the non-funding argument, the Postal Service should not set aside money when it promises future health benefits in return for current services; the obligations should be financed and recorded as expenses only when the promises must be redeemed. In this vein, Fredric Rolando, President of the National Association of Letter Carriers (NALC), asserts, "The red ink at USPS has nothing to do with the mail, the Internet, or related factors. It results from politics. In 2006, a lame-duck Congress mandated that the Postal Service prefund future retiree health benefits... [That's] the red ink."<sup>20</sup>

This don't-worry-now-about-what-you-promise-now-to-pay-later argument has numerous flaws. First, the Postal Service lost \$51.7 billion from 2007 to 2014, while its RHBF payments and defaults during the period totaled \$40.3 billion. Hence, even if the Service's huge unfunded retiree health care liability were ignored and the RHBF never existed, the Service would still have lost serious money over the period. Second, if promises are treated as free until they come due, enterprises could easily hide costs related to current operations simply by shifting payments into the future, thereby falsifying their true financial situations. Third, if Postal Service obligations are not funded when they are incurred and the Service tries to be self-supporting, future postal customers will unfairly be forced to pay costs attributable to past mail service. Finally, as mentioned earlier, unfunded promises may lead to a taxpayer bailout. The desire to reduce this hazard was a major impetus for establishing the RHBF. Regrettably, mail demand crashed soon after the RHBF was established, and retiree health care obligations are still massive, an estimated \$48.9 billion at the end of 2014.<sup>21</sup>

With these thoughts in mind, GAO advises, "USPS should prefund any unfunded retiree health liability to the maximum extent that its finances permit."<sup>22</sup> Because some stakeholders have incorrectly claimed that the RHBF goes overboard and tries to fund benefits for future employees, some not even born, GAO adds, "Contrary to statements made by some employee groups and other stakeholders, these liabilities [for future retiree health care] do **not** include any amounts for future USPS employees not yet hired or born."<sup>23</sup> [Emphasis added.] Clearly, the ultimate financial backstop for the Postal Service remains a taxpayer bailout, as the Service noted in the most recent Form 10-K statement it filed with the Postal Regulatory Commission (PRC), "[I]t is unlikely that in the event of a cash shortfall, the Federal Government would allow us to significantly curtail or cease operations."<sup>24</sup>

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20 Daniel Kline, "Amazon's Deal With the United States Postal Service Could Hold the Key to the Mail Deliverer's Future," *The Motley Fool*, Oct. 1, 2014, <http://www.fool.com/investing/general/2014/10/01/amazons-deal-with-the-united-states-postal-service.aspx>.

21 Postal Service, *Form 10-K*, 2014, p. 27.

22 Todisco, GAO, *Action Needed to Address Unfunded Benefit Liabilities*, *op. cit.*, p. 11.

23 *Ibid.*, p. 6.

24 Postal Service, *Form 10-K*, 2014, *op. cit.*, p. 32.

## Difficulty Meeting Service Standards

The Postal Service's fundamental mission is to deliver letter mail and to do so with reasonable promptness and reliability. If mail is seriously and unpredictably delayed or, worse, never arrives, some of the dangers for households and businesses that rely on the mail are being hit with late fees on bill payments, having government agencies and businesses reject forms and applications because they arrive past deadlines, running out of prescription medications while waiting for the next 90-day supply in the mail, and having advertising promotions fail because promotional circulars do not reach customers' doors until after the sales have ended.<sup>25</sup>

The Service's high favorability rating with the public indicates that, on average, it has performed well for many years. Stories from dissatisfied mail users, of course, tell us its performance has been far from perfect. The Service's ability to continue providing a generally satisfactory customer experience as it reduced its workforce over the last 15 years is a testament to the skill of its leadership and the hard work of its employees.

Alarming, however, the agency's delivery-time numbers for 2014 suggest cracks may be starting to appear. The PRC reports that the Service fell short of seven out of eight delivery-time targets for First-Class and Standard Mail in 2014.<sup>26</sup> The worst deficiencies were for 3-5 day single-piece First-Class Mail, which missed its on-time target by 7.6 percent (87.7 percent was on-time compared to the target of 95.25 percent), 3-5 day presort First-Class Mail, which missed its target by 3.1 percent (92.2 percent was on-time compared to the target of 95.25 percent), and Standard Mail, which missed its target by 4.6 percent (86.4 percent was on-time compared to the target of 91.0 percent).

The slippage is even more pronounced in calendar year 2015.<sup>27</sup> For example, the Service reports that, in the January-March quarter, on-time delivery slumped to 63.1 percent for 3-5 day single-piece First-Class Mail, compared to 84.1 percent in the same quarter last year. It dropped to 80.6 percent for 3-5 day presort First-Class Mail, compared to 89.9 percent in the same quarter last year. It edged down to 76.5 percent for periodicals, compared to 79.2 percent in the same quarter last year.

In discussing the January-March results, the Postal Service suggested the disappointing numbers were only a hiccup. It pointed to "[a] large number of winter storms" and the challenge of adjusting to major operational changes that "impacted ... nearly all processing and transportation activities nationwide."<sup>28</sup> On the other hand, it should be noted that, as

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25 To be sure, households and businesses can obtain extremely fast delivery by paying for overnight service from a private-sector company or the Postal Service itself. However, people also care about costs, and they only select express delivery when the need is urgent. People's market decisions suggest they are generally satisfied with the Postal Service's speed-price combination if delivery is reasonably quick and, just as important, reliable.

26 Postal Regulatory Commission, *Analysis of the Postal Service's FY 2014 Program Performance Report and FY 2015 Performance Plan*, Jul. 7, 2015, p. 3, <http://www.prc.gov/docs/92/92717/2014%20Report%202015%20Plan.pdf>. Standard Mail (once called Third-Class Mail) is bulk commercial mail with lower rates but generally slower delivery than First-Class Mail.

27 For links to the data, see Postal Service, *Service Performance Results; Service Performance Targets FY2015 Market Dominant Products*, <http://about.usps.com/what-we-are-doing/service-performance/welcome.htm>.

28 Postal Service, *Quarterly Performance for Single-Piece First-Class Mail*, Quarter II, FY2015, <http://about.usps.com/what-we-are-doing/service-performance/fy2015-q2-single-piece-first-class-mail-quarterly-performance.pdf>.



part of those operational changes, the Postal Service relaxed its performance standards for First-Class and Periodical Mail at the start of 2015. With some slower deliveries now counting as on time, delivery scores should have improved.

Service performance was not quite as bad in the April-June quarter but still markedly worse than in the past. For example, on-time delivery was 77.1 percent for 3-5 day single-piece First-Class Mail in the April-June quarter, versus 90.0 percent in the same quarter last year. It was 88.7 percent for 3-5 day presort First-Class Mail, versus 93.5 percent in the same quarter last year. It was 78.4 percent for periodicals, versus 85.4 percent in the same quarter last year.

The Postal Service's Office of the Inspector General (OIG) responded to the additional billions of pieces of delayed mail by launching an investigation. The OIG concluded that the Service does take the matter seriously and is trying to identify and correct specific problem areas by, for example, adding air and surface transportation and sending in "tiger teams" to tackle deficiencies.<sup>29</sup> The PRC is also concerned and, to increase public visibility, has begun posting the quarterly performance scores more prominently on its website.<sup>30</sup>

One hopes the Service's reassurances that service will soon return to normal are well founded. This is an important issue, and the government agency's on-time delivery scores in coming quarters should be watched closely.

## Is the Postal Service Losing Its Focus on Traditional Mail Users?

Because of the Internet revolution, First-Class Mail and Periodicals are in sharp, long-term declines in terms of both volume and revenue. As for Standard Mail, demand has been relatively stable for several years but at a level far below that reached earlier. These products are all market-dominant products, a classification reserved for products on which the Postal Service holds a statutory monopoly or exerts substantial market power. In contrast, sales of the agency's Shipping and Package Services, which are predominantly competitive-market products, are rising quickly because households and businesses need delivery of the merchandise they are increasingly ordering over the Internet. The Service reports that volume and revenue for Shipping and Package Services jumped 20 percent and 31 percent, respectively, from 2008 to 2014.<sup>31</sup>

While growing rapidly, Shipping and Package Services still account for only about 20 percent of the Postal Service's revenue.<sup>32</sup> At the end of 2014, revenue from First-Class Mail was more than double that from Shipping and Package Services, and revenue from Standard Mail was 25 percent higher.<sup>33</sup> First-Class and Standard Mail are even more important when

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29 Office of Inspector General, U.S. Postal Service, Management Alert – Substantial Increase in Delayed Mail, Report Number NO-MA-15-004, Aug. 13, 2015, <https://usps.oig.gov/sites/default/files/document-library-files/2015/no-ma-15-004.pdf>.

30 See Postal Regulatory Commission, *Quarterly Service Performance Reports*, <http://www.prc.gov/dockets/quarterly-performance>.

31 Postal Service, *Annual Report to Congress, 2014*, *op. cit.*, p. 43; and Postal Service, *Annual Report to Congress, 2012*, p. 21, <http://about.usps.com/publications/annual-report-comprehensive-statement-2012/annual-report-comprehensive-statement-2012.pdf>.

32 Postal Service, *Annual Report to Congress, 2014*, *op. cit.*, p. 43.

33 *Ibid.*

it comes to net income. The PRC found that in 2014, on average, the revenue from each piece of First-Class Mail covered 220 percent of the costs attributed to that piece of mail, and Standard Mail had an average cost coverage ratio of 166 percent.<sup>34</sup> Domestic Shipping and Package Services achieved a substantially lower cost coverage ratio, approximately 135 percent.<sup>35</sup>

If these profit margins seem outlandishly high for a business that regularly posts losses in the billions of dollars, it is because relatively few costs—53 percent—are actually allocated to specific products, with the remaining 47 percent considered joint or “institutional” overhead. This has created a considerable transparency issue with respect to product profitability. In 2004, then-Secretary of the Treasury John Snow criticized “this large, unallocated portion [as] a sort of ‘elephant in the room.’”<sup>36</sup> One reason for his concern was that if some product-related costs are incorrectly categorized as overhead, it becomes uncertain which products are covering their true costs and by how much, and whether some products that supposedly help financially are actually losing money.

It is human nature to chase after new opportunities, and the Postal Service, looking to the future, is aggressively trying to increase its package delivery sales. The agency declared in its 2014 Annual Report, “The Postal Service is at the center of a rapidly evolving industry and is capitalizing on its strengths to grow its package delivery business... [USPS is] focused on generating new revenue and exciting its customers [with] innovative and creative initiatives...”<sup>37</sup>

The agency’s enthusiasm is commendable, but its push in this area does raise two concerns. Will it help the Service’s bottom line? Will the heightened emphasis on merchandise delivery hurt service for users of traditional mail products?

For example, the Service reports that it has begun delivering packages seven days a week in over 650 cities. “Sunday delivery,” it says, “serves the needs of valued customers in today’s busy online world while at the same time, generates new revenue for the Postal Service.”<sup>38</sup> Puzzlingly, however, the Service has been claiming since 2009 that it could narrow its losses by trimming regular mail delivery from six days a week to five. If six-day-a-week mail delivery harms profitability, how does seven-day-a-week merchandise delivery help the bottom line? The Service should fully and publically explain with revenue and cost numbers why it expects

34 Postal Regulatory Commission, *Financial Analysis of United States Postal Service, Financial Results and 10-K Statement, Fiscal Year 2014*, Apr. 1, 2015, pp. 73-74, <http://www.prc.gov/sites/default/files/reports/Financial%20Report%202014.pdf>.

35 *Ibid.* The ratio in the text is based on the following categories used by the PRC in its analysis of the Service’s 2014 financials: Priority Mail Express, Priority Mail, Total Ground, First-Class Package Service, Competitive Domestic Services, Alaska Bypass, Bound Printed Matter Flats, Bound Printed Matter Parcels, and Media Mail/Library Mail. The overwhelming majority of the total is classified as competitive mail: 94 percent in terms of revenue and 93 percent in terms of costs. Priority Mail and Priority Mail Express are mostly, but not entirely, packages. If they were excluded, the cost coverage ratio computed here would be slightly lower.

36 John W. Snow, Hearing Testimony the Honorable Secretary of the Treasury on Reform of the United States Postal Service, Before a Joint Session of the Committee on Government Reform, United States, House of Representatives and Committee on Governmental Affairs, United States Senate, JS-1255, Mar. 23, 2004, <http://www.treasury.gov/press-center/press-releases/Pages/js1255.aspx>. Two years after Secretary Snow’s testimony, Congress enacted PAEA, which changed postal rate regulation. Costs now play a less central role in the rate setting process than they did then, although products are still supposed to cover their costs. Another change since then is that the share of Postal Service costs assigned to general overhead has climbed even higher, rising by about five percentage points.

37 Postal Service, *Annual Report to Congress, 2014*, *op. cit.*, p. 46.

38 *Ibid.*, p. 4.

Sunday package delivery to be profitable. Unless the agency can do that, its willingness to deliver merchandise more frequently than other mail creates the appearance that it is taking customers of its market dominant products for granted and may be digging a deeper financial hole that will increase risks for traditional mail users and for taxpayers.

In another initiative aimed at speedy delivery, the Service “pilot-tested MetroPost, a same-day delivery service” in San Francisco and New York.<sup>39</sup> Notwithstanding upbeat comments about Metro Post in the Service’s 2014 Annual Report,<sup>40</sup> the agency’s Office of the Inspector General (OIG) found that in San Francisco “[o]nly 95 packages were sent ... over a 5-month period.... As a result, the Postal Service earned \$760 and spent \$10,288, with a net loss of \$9,528 on the pilot.”<sup>41</sup> The Service suspended Metro Post in San Francisco in early 2014 but hopes for better results in New York City, and announced this year that it is bringing the program to the Washington, DC area.<sup>42</sup> The hard numbers from San Francisco show it is difficult for a large government enterprise to succeed in a low-margin, rapidly evolving, intensely competitive market. Metro Post has brought no benefits to traditional mail users, either in the form of improved service quality or by helping support the agency.

In another example of why it is unclear where the agency’s loyalties reside, it comments, “The Postal Service is ‘Delivering a New Day’ by ... streamlining its mail processing operations so it can invest in new package sorting equipment and other upgrades.”<sup>43</sup> A benign interpretation is that with shifts in the mail mix, the Service simply needs to rebalance its deployment of workers, facilities, and equipment to equalize workloads in processing traditional mail and packages. A more worrisome interpretation is that the Service is downgrading its processing of traditional mail to finance a higher level of service for merchandise shipments. It is not obvious which interpretation is correct or whether both are true to some extent.

As Shipping and Package sales expand, it is natural that the Postal Service will direct an increasing number of work-hours and investment dollars to those products. For instance, in replacing its aging fleet of delivery vehicles, the Service is apparently seeking changes to better configure them for packages; they are now optimized for letter mail.<sup>44</sup> A concern, though, is whether the additional resources used by competitive-market products will be properly attributed. As pointed out above, the agency currently attributes barely more than half its costs to its products while consigning all the rest to general overhead. If some of the costs related to Shipping and Package Services are mistakenly categorized as overhead or, worse, attributed to letter mail, the profitability of Shipping and Package activities will be overstated. Given that most of those products have low cost coverage ratios, far below the

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39 *Ibid.*, p. 11.

40 See *Ibid.*, pp. 4, 11, and 60.

41 Office Of Inspector General, United States Postal Service, *Metro Post Same Day Delivery Pilot – San Francisco District*, Report Number DR-MA-14-002, Feb. 5, 2014, Highlights page, <https://www.uspsig.gov/sites/default/files/document-library-files/2014/dr-ma-14-002.pdf>. Also see Erin Lynch, *USPS to End Metro Post Same-Day Delivery Program*, MULTICHANNEL MERCHANT, Feb. 12, 2014, <http://multichannelmerchant.com/news/usps-end-metro-post-day-delivery-program-12022014>.

42 USPS Expands Same-Day Deliveries From SF And NYC To DC,” PYMNTS.COM, Jan. 7, 2015, <http://www.pymnts.com/news/2015/usps-expands-same-day-deliveries-from-sf-and-nyc-to-dc>.

43 Postal Service, *Annual Report to Congress, 2014*, *op. cit.*, p. 46.

44 See Lisa Rein, *USPS Seeks Bids On New Postal Trucks; Vans Will Be Built To Hold More Packages*, THE WASHINGTON POST, Feb. 13, 2015, <http://www.washingtonpost.com/blogs/federal-eye/wp/2015/02/13/usps-seeks-bids-on-new-postal-trucks-new-vans-will-be-built-to-hold-more-packages>.

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average for market-dominant products, it would not take much of a cost misallocation for some competitive-market products that are actually losing money to show up as profitable in the Service's financial statements. With the Postal Service holding out Shipping and Package Services as the star of its future business model, it is especially important that cost allocation be gotten right.

If the Postal Service were an ordinary business, it would not be surprising or objectionable if it favored the growing market over the mature one. Businesses often try to reinvent themselves, leaving behind old markets and customers. However, the Service is a government enterprise; it has a public service mission "to provide universal mail service to the citizens of the United States;"<sup>45</sup> it enjoys a statutory monopoly that forces households and businesses who want services like First-Class Mail and Standard Mail to buy them from the U.S. Postal Service; and it possesses a second statutory monopoly that bars anyone except USPS from placing mailable items (billing statements, circulars, community notices, etc.) in people's mailboxes.<sup>46</sup> In addition, by law, the Postal Service is to prioritize the "delivery of important letter mail."<sup>47</sup> Because of these facts, unless Congress changes the Postal Service's mission and rescinds its monopoly, USPS has a continuing responsibility to maintain its focus on meeting the needs of traditional mail users.

## Rural Complaints

The Postal Reorganization Act of 1970, which transformed the old Post Office Department into the Postal Service, directs the organization to "provide a maximum degree of effective and regular postal services to rural areas, communities, and small towns."<sup>48</sup> However, because Congress and a succession of Administrations were weary of the massive postal losses that were a drain on the federal budget in the 1950s and 1960s, the legislation also orders that "the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service."<sup>49</sup> There is a potential conflict between these directives, but before mail demand began falling, the Service could satisfy both. When demand weakened, however, the agency felt compelled to look harder for places to reduce costs, and one of those places has been rural service.

In 2011, the Service introduced a plan called the Retail Access Optimization Initiative that could have resulted in the closure of over 3,600 low-volume post offices, most in rural areas.<sup>50</sup> The opposition was immediate and intense, and much of it was from rural communities and their elected representatives. For instance, then-Senator Olympia Snowe (R-ME) wrote to the Postmaster General, "While I understand the imperative to reduce costs,

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45 *Ibid.*, p. 74.

46 The mailbox monopoly is codified in 18 U.S.C. 1725. Congress enacted the mailbox monopoly in 1934 to bolster the Post Office Department's revenue. That the primary motive—money, not mailbox security—is revealed by the fact that the statute, which is part of the U.S. criminal code, provides an exception: anyone can place items in people's mailboxes—provided they first pay full postage.

47 39 U.S.C. 101(e).

48 P.L. 91-375, sec. 101.

49 *Ibid.*, sec. 3621.

50 For a thorough analysis of the plan, see Postal Regulatory Commission, *Advisory Opinion On Retail Access Optimization Initiative*, Docket No. N2011-1, Dec. 23, 2011, [http://www.prc.gov/docs/78/78971/N2011-1\\_AdvisoryOP.pdf](http://www.prc.gov/docs/78/78971/N2011-1_AdvisoryOP.pdf).

it is absolutely critical that your actions not tear at the fabric of island communities and rural towns and villages by denying them the reliable, affordable and convenient postal service currently provided.”<sup>51</sup>

In May 2012, the Service announced an alternative to the closings: shorter hours at 13,000 rural post offices (open two, four, or six hours per workday instead of the normal eight.)<sup>52</sup> The modified plan proved less unpopular with the public, and it had the side benefit for the Service of increasing the projected annual savings from \$200 million under the original plan to \$500 million. Still, people who go to post offices with reduced hours cannot help but be reminded, as they carefully schedule their visits, that they are receiving a lower level of service than is normal in more populous areas.

People in rural areas may also feel slighted because some of the Service’s recent initiatives, such as Sunday package delivery and various forays into same-day merchandise delivery, are aimed at city dwellers, with the same-day options targeted even more narrowly at affluent residents of a few large cities.<sup>53</sup>

The closing of mail processing plants has been another source of discontent in rural states, with many elected officials from those states objecting loudly. Some rural states have lost a large percentage of their processing plants (for instance, Montana went from nine plants in 2010 to three today<sup>54</sup>); in some rural states the distances between processing plants were already long and now they are much longer; and in many rural states, there are few jobs with wage and benefit packages comparable to what the old postal processing plants offered.

Some lawmakers have responded by seeking to better measure on the quality of rural service. In an initiative the agency supports, Senator Roy Blunt (R-MO) added language to a Senate Appropriations bill requiring data to be collected on the speed with which mail is delivered to and from rural areas.<sup>55</sup> Some lawmakers call for sweeping changes. For instance, Senator Heidi Heitkamp (D-ND) introduced the Rural Postal Act of 2015 (S. 1742) which would, among its many provisions, make it harder to close rural post offices or shorten their hours, order a study on providing WiFi at all rural post offices, impose a two-year moratorium on further processing plant closings, and require the Postal Service to return to the service standards in effect on July 1, 2012.<sup>56</sup> The Heitkamp bill would be expensive. The Congressional Budget Office (CBO) has estimated that the cost of fully implementing one

51 *Snowe Urges USPS to Examine Impact of Post Office Closures on Rural Communities*, POLITICALNEWS.ME, Jul. 30, 2011, <http://politicalnews.me/?id=8494&keys=POST-OFFICES-USPS-RURAL>.

52 For a brief overview, see Amy Bingham, *USPS to Cut Hours, Not Close Post Offices*, ABC NEWS, MAY 9, 2012, <http://abcnews.go.com/blogs/politics/2012/05/usps-to-cut-hours-not-close-post-offices>. For a detailed analysis of what USPS called the Post Office Structure Plan (POStPlan), see Postal Regulatory Commission, *Advisory Opinion On Post Office Structure Plan*, Docket No. N2012-2, Aug. 23, 2012, [http://www.prc.gov/docs/85/85013/N2012-2\\_Adv\\_Op\\_082312.pdf](http://www.prc.gov/docs/85/85013/N2012-2_Adv_Op_082312.pdf).

53 See, for instance, George Landrith, *Postal Service Is Leaving Rural Iowa Behind*, THE GAZETTE (Cedar Rapids, IA), Jul. 18, 2015, <http://thegazette.com/subject/opinion/postal-service-is-leaving-rural-iowa-behind-20150718>.

54 Senator Jon Tester, *Tester Hosts Roundtable On Postal Delivery In Rural America*, May 19, 2015, [http://www.testersenate.gov/?p=press\\_release&id=3948](http://www.testersenate.gov/?p=press_release&id=3948).

55 Kim Ukura, *National Newspaper Association: Is The Mail On Time In Rural Areas? U.S. Postal Service Is Going To Be Asking*, MORRIS SUN TRIBUNE (MORRIS, MN), JUL. 25, 2015, <http://www.morrissuntribune.com/opinion/3804037-national-newspaper-association-mail-time-rural-areas-us-postal-service-going-be>.

56 Senator Heidi Heitkamp, *Rural Postal Act of 2015*, One Page Summary, [http://www.heitkamp.senate.gov/public/\\_cache/files/9fe4e103-e7b3-4dd1-b21c-21797a1b9780/rural-postal-act-one-pager.pdf](http://www.heitkamp.senate.gov/public/_cache/files/9fe4e103-e7b3-4dd1-b21c-21797a1b9780/rural-postal-act-one-pager.pdf).

of its provisions, rolling back service standards to those effective on July 1, 2012, would, by itself, take more money than the Service has available.<sup>57</sup>

The Rural Postal Act does highlight a basic choice Congress should make. If there is a valid public service need for substantially better rural mail service, Congress should specify how the enhanced rural services are to be funded, rather than enacting unfunded mandates the debt-ridden Postal Service cannot afford. The most direct and transparent approach would be grant USPS a public service appropriation based on the costs of the enhanced rural services. And because the federal deficit is already so large, the responsible way for Congress to fund this appropriation would be to identify, and cut, some existing, lower priority federal outlays. An alternative would be for Congress to approve a special postal rate hike sufficient to cover the added costs it mandates.<sup>58</sup> With both approaches, Congress would have to acknowledge the costs it is imposing rather than only taking credit for benefits.

## Conclusion

Rapidly shrinking mail volume is a global phenomenon. The downdraft is so pervasive that an executive at Pos Malaysia consoled himself by saying, “It’s a worldwide trend.... It has been the same here as well but our decline is not as bad...”<sup>59</sup> The fall in demand has strained many foreign posts. In Canada, for instance, two contentious issues are that Canada Post has raised the single-stamp price for mailing an ordinary domestic letter to \$1 CAD (about \$0.77 U.S.) and is phasing out to-the-door mail delivery.<sup>60</sup>

Where the U.S. Postal Service sticks out is in the magnitude of its losses. In fairness to the organization, one of the problems has been congressional micromanagement, which severely limits managerial flexibility in responding to market changes. Still, the flood of red ink and some of the Postal Service’s efforts to stanch the flow need to be monitored carefully because they present dangers to current and future mail users and to taxpayers.

57 Congressional Budget Office, *Additional Information about the Estimated Costs of the Amendment to the FY 2016 Financial Services and General Government Appropriations Bill*, Cost Estimate, Jul. 13, 2015, <https://www.cbo.gov/sites/default/files/114th-congress-2015-2016/costestimate/fattahamendmentltr.pdf>.

58 The higher postal rates would, in effect, be a cross-subsidy from non-rural mail users to rural ones. Although it is often assumed that rural postal subsidies are justified, some observers would dissent. Their argument would be that living outside cities provides an assortment of benefits, such as less congestion and lower housing costs, along with disadvantages, such as longer distances to retail stores and medical care. People choose where to live based on the costs and benefits. Therefore, the argument continues, while it would be good if the government could reduce the costs of rural life without imposing costs on anyone else, it is unfair and economically distortionary to subsidize people in rural areas at the expense of the rest of society. It is beyond the scope of this paper to evaluate whether this argument has merit.

59 Sim Wie Boon, *Snail Mail Demand Still High In Malaysia*, THE RAKYAT POST, June 16, 2015, <http://www.therakyatpost.com/business/2015/06/16/snail-mail-demand-still-high-in-malaysia>.

60 For Canada Post’s current rates, see Canada Post, *Postal Prices 2015*, <https://www.canadapost.ca/cpo/mc/personal/ratesprices/postalprices.jsf>. For an angry reaction to the demise of to-the-door delivery, see David Martin, *Canada Post’s Community Mailboxes Are a Disgrace*, THE HUFFINGTON POST, July 14, 2015, [http://www.huffingtonpost.ca/david-martin/community-mailboxes-canada-post\\_b\\_7785382.html?utm\\_hp\\_ref=canada-business](http://www.huffingtonpost.ca/david-martin/community-mailboxes-canada-post_b_7785382.html?utm_hp_ref=canada-business).