

POSTAL TRENDWATCH

The Lexington Institute
1600 Wilson Boulevard, Ste. 900
Arlington, VA 22209
703-522-5828
www.lexingtoninstitute.org
Postal TrendWatch
Q2FY10

Q2 FY 2010: USPS Launches Transformation Plan

Executive Summary

The U.S. Postal Service lost \$1.58 billion in the second quarter of FY 2010. USPS says that it has experienced negative operating results in 13 of the last 15 quarters. Operating revenue declined by \$241 million, or 1.4 percent, relative to Q2 FY 2009. Total volume declined by about 1.4 billion pieces, or 3.3 percent, compared to the same quarter last year.

On March 2, Postmaster General John Potter released a landmark 10-year strategic plan outlining steps to "maintain a viable United States Postal Service." Absent massive changes, USPS projects a cumulative shortfall of up to \$238 billion over the next decade. The Service believes it can come up with \$123 billion in savings through internal restructuring. For the remaining \$115 billion, USPS plans to seek additional operational flexibility from Congress so that it can close facilities, reduce delivery service, modify prices, and delay contributions to the retiree health benefit fund, among other things.

with the 2010 U.S. Census. Notably, Standard Mail volume increased slightly, by about 121 million pieces, or 0.6 percent, over the same period last year.

For the second straight quarter, USPS's shipping services showed improvement over the corresponding period last year. Revenue and volume for this category increased 5.7 percent and 1.5 percent, respectively, compared to Q2 2009.

USPS Strategic Plan Triggers New Requests for Flexibility

On March 2, the Postal Service made waves by releasing a strategic plan for transforming the agency over the next decade predicting steep and unprecedented deficits. Absent dramatic changes, Postmaster General John Potter projected cumulative 10-year losses of as much as \$238 billion.

The report -- *Ensuring a Viable Postal Service for America* -- lays out a plan for covering that shortfall. Potter suggested that USPS could achieve \$123 billion in savings under current law. In order to make up the remaining \$115 billion shortfall, the Service is requesting that Congress change several laws governing the agency's activities.

Specifically, the Postal Service would like Congress to modify its retiree health-benefit funding obligations and to grant the agency more control over workforce management, pricing, new products, delivery frequency, and facilities management.



Quarterly Highlights

First Class and Standard Mail volume dipped 3.1 percent compared to the same period last year. First Class revenue declined by \$409 million relative to Q2 FY 2009, despite an injection of \$180 million thanks to mail deliveries associated

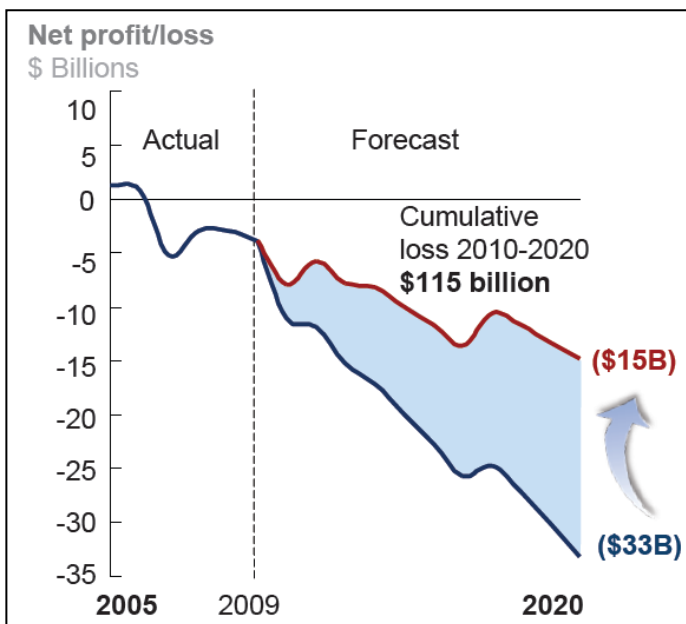
Postal Service Presses Ahead with 5-Day Delivery Request

USPS continued its push for the elimination of Saturday mail delivery by filing a request with the Postal Regulatory Commission for an advisory opinion on the legality of the proposed reduction in service.

The Postal Service has admitted that a switch to five-day delivery would generate no savings in 2010; at best, the agency would begin realizing savings in mid-2011.

In its 10-year strategic plan, the Postal Service projected that five-day delivery would save the agency \$3 billion annually. The Postal Regulatory Commission puts the savings at \$2 billion a year. Both figures amount to less than 5 percent of USPS's yearly expenses.

USPS Projects \$238-Billion Loss over 10 Years



Red - Loss Trendline with USPS cost-cutting measures
Blue - Loss Trendline without USPS cost-cutting measures

Sources: USPS, "Ensuring a Viable Postal Service for America: An Action Plan for the Future;" McKinsey Analysis.

USPS Backs Away from Non-Postal Pursuits

USPS appears to have tempered its previous enthusiasm for launching new non-postal products. In the appendix to *Ensuring a Viable Postal Service for America*, the agency stated that non-mail products were "not viable for the Postal Service because of its net losses, high wage and benefits costs, and limited access to cash to support necessary investments."

The Service commissioned a report from Accenture that analyzed how national posts in other countries have diversified their businesses as the postal market has changed. The study noted that diversification away from core mail offerings generally required significant resources, the development of new capabilities, and ample time to fully implement new services. Even with these necessary ingredients, most international posts have generated below-average profitability from their non-postal offerings, when compared to industry benchmarks.

Accenture posited that USPS would not be able to pursue a diversification strategy until it had rebuilt a profitable mail business to fund new ventures or acquisitions. The consultancy also said that diversification would require substantial changes to USPS's labor model, product portfolio, and cost mix.

Given the Postal Service's already high debt levels, its relatively small window of time for putting its fiscal house in order, and the reluctance of legislators to permit changes to the agency's labor model, non-postal products will likely play little -- if any -- role in the agency's immediate future.

Some leaders in the postal community, including Postal Regulatory Commission Chair Ruth Goldway, have encouraged the Postal Service to expand partnerships with other government agencies. In April testimony before the Senate, Goldway envisioned the USPS of the future as "a one-stop shop for government services."

"It is clear that we have not recognized that the Postal Service has more workers than it needs."

-- Darrell Issa (R-Calif.)

Labor Still a Key to Postal Reform

The Postal Service's labor cost structure continues to hamper management's efforts to achieve the cost reductions necessary to keep the Service afloat. A study conducted by McKinsey & Company and commissioned by the Postal Service found that the number of pieces per Full Time Equivalent, based on work hours, has continued to fall from a high of 265,000 in 2007 - despite a substantial reduction in the size of the USPS workforce. This suggests that productivity is declining.

Rep. Darrell Issa (R-Calif.) believes that further reductions may be necessary. "It is clear that we have not recognized that the Postal Service has more workers than it needs," said Issa at a hearing in April.

An April report from the Government Accountability Office also highlighted the importance of labor reforms to the Postal Service's viability. The GAO suggested that the Postal Service could adjust its workforce mix by

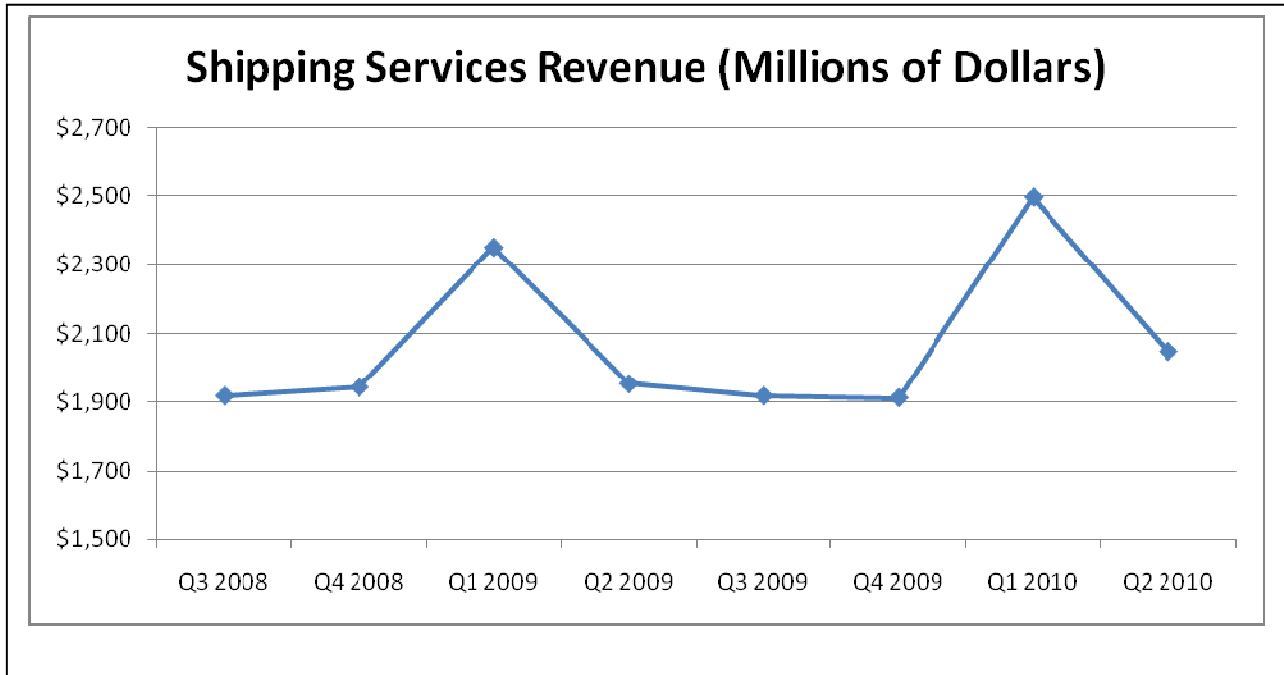
hiring more part-time staff. At present, 78 percent of employees are full-time.

USPS Inspector General David Williams has argued for more labor flexibility. In March testimony before the Senate, Williams said, "The ebb and flow of mail in the processing plants suggests the need for more flexible staff willing to perform a wider range of duties. The current method of paying carriers by the hour requires closer management than is possible and disincentivizes optimal performance."

The report also proposed reducing postal wages and benefits as a means of cutting costs. Although the Postal Service is required to maintain compensation comparable to the private sector, decades of economic research suggest that unionized postal workers are paid about a third more than analogous private-sector workers. With benefits, the compensation premium for postal workers can exceed 40 percent.

"USPS's share of the health and life insurance premium payments could be reduced to levels paid by most federal agencies, which would increase the employees' annual premium payments and, according to USPS estimates, would have saved about \$615 million in fiscal year 2009."

-- April 2010 GAO Report



Source: USPS Quarterly Statistics Reports

Compared to other government institutions, USPS also offers more generous benefits. The GAO reported that the Postal Service paid 81 percent of health benefit premiums in fiscal 2009; on average, other federal agencies paid 72 percent of premiums. USPS also paid the entirety of its employees' life insurance premiums; the rest of the federal government covered just a third of such premiums.

One option available to postal managers as they contemplate ways to cut costs, according to the GAO, is fixing these discrepancies: "USPS's share of the health and life insurance premium payments could be reduced to levels paid by most federal agencies, which would increase the employees' annual premium payments and, according to USPS estimates, would have saved about \$615 million in fiscal year 2009."

Labor accounts for 80 percent of USPS costs, so increased workforce flexibility is crucial to any rescue plan. For instance, efforts to outsource government work to the Postal Service may fall flat if USPS labor ends up being more expensive than existing government labor, as the wage and compensation premium suggests.