POSTAL TRENDWATCH

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Postal TrendWatch
Q3FY10

Q3 FY 2010: Uncertainty over USPS Financial Future

Executive Summary

The U.S. Postal Service lost $3.5 billion in the third quarter of FY 2010. USPS says that it has lost money in 14 of the last 16 quarters. Operating revenue declined by $294 million, or 1.8 percent, relative to Q3 FY 2009. Total volume declined by about 707 million pieces, or 1.7 percent, compared to the same quarter last year. Operating expenses, meanwhile, increased by $789 million, or 4.2 percent, over the same period.

The Postal Service has said that it may not be able to make the $5.5 billion payment it owes at the end of FY 2010 to the Postal Service Retiree Health Benefits Fund. The USPS Inspector General reported that the Postal Service may have overfunded its pension obligations by $75 billion, while the Postal Regulatory Commission released a report that calculated the USPS overpayment at about $50 billion. Just after the close of Q3, on July 6, 2010, the Postal Service filed a request for an exigent rate increase averaging 5.6 percent.

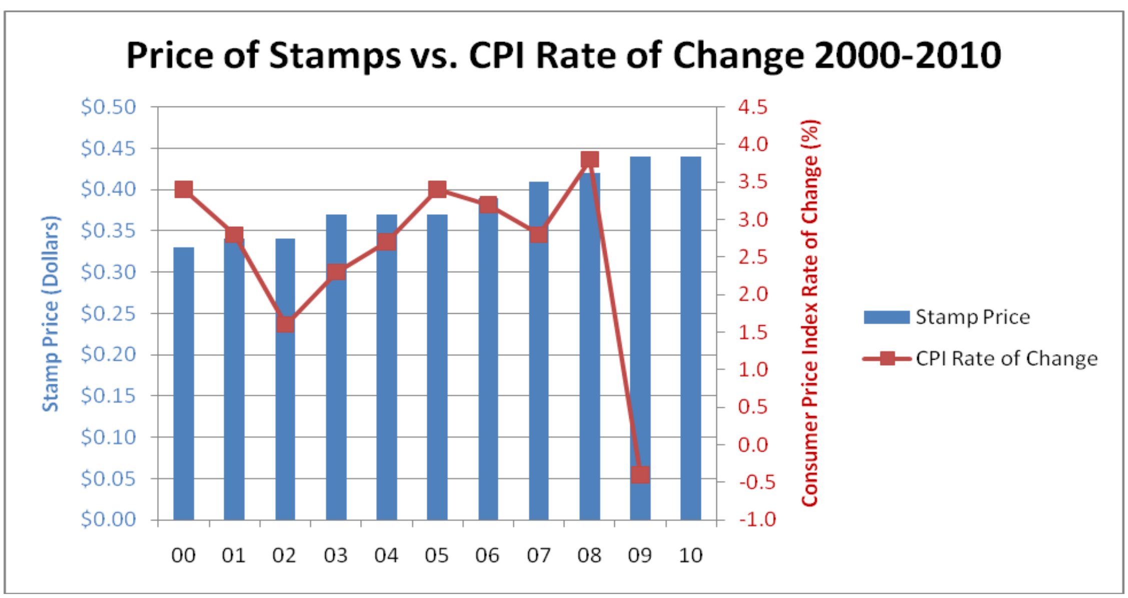
The uncertainty surrounding the Postal Service's finances is certain to play a major role in the agency's contract negotiations with its labor unions, which will begin this fall.

Quarterly Highlights

First Class Mail volume dipped 6.7 percent compared to the same period last year. First Class revenue declined by $452 million relative to Q3 FY 2009. Standard Mail volume increased for the second consecutive quarter, by about 794 million pieces, or 4.2 percent, over the same period last year.

Operating expenses increased by $789 million, or 4.2 percent, in Q3 FY 2010, thanks largely to adjustments in workers' compensation obligations and increased retiree health benefits expenses. USPS points out that these expenses are not subject to management's control. Without these two expenditures, operating expenses would have decreased 0.5 percent compared to the same quarter last year.

Spending on compensation and benefits declined 2.2 percent this quarter relative to Q3 FY 2009. To help further control spending, USPS has instituted a hiring and promotions freeze for administrative jobs.



Uncertainty Surrounds USPS Pension Payments

Both the Postal Regulatory Commission and the USPS Office of Inspector General reported that the Postal Service may have overfunded its pension obligations by tens of billions of dollars. In January 2010, the OIG concluded that USPS had overfunded its obligations to the Civil Service Retirement System (CSRS) by $75 billion since the 1970s. An independent actuary employed by the PRC reported on June 30, 2010, that the amount of overfunding was closer to $50-55 billion.

On August 16, 2010, the OIG reported that the Postal Service may also have contributed $6.8 billion more than required to the Federal Employees Retirement System (FERS), which covers most employees hired after January 1, 1984.

Congress is expected to consider legislation in either late 2010 or early 2011 to rectify these issues and reconcile different accounting methodologies.

Any new infusion of funds in this range would likely have a major impact in the Postal Service's operating climate. But such a plan would not alter the Postal Service's most immediate concern, a $5.5 billion payment due to its Retiree Health Benefits Fund on September 30, 2010. Without legislative action, USPS will not have the cash to make that payment.

Postal Service Files Exigent Rate Case

The 2006 Postal Accountability and Enhancement Act limited increases in the price of postage for monopoly products to the inflation rate. But the legislation also established a procedure for an "exigent" rate case to raise prices beyond the inflationary cap in certain extraordinary or exceptional circumstances.

On July 6, 2010, the Postal Service filed a request with the PRC for an exigent price increase averaging 5.6 percent that would go into effect January 2, 2011. This is the first time USPS has filed such a case.

The Postal Service projects that this rate increase will generate an additional $3 billion in revenue each year. In its 10-Q report for Q3 FY 2010, USPS stated that the price increase would not be sufficient to offset the liquidity shortfall projected for 2011.

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>
> *-- Sen. Susan Collins (R-Maine)*

Several leading postal authorities have come out against the proposed price increase. In a letter sent to the Postal Regulatory Commission on August 9, 2010, Sen. Susan Collins (R-Maine) wrote, "Neither the language nor the legislative history of the PAEA authorizes the United States Postal Service to file an exigent rate case under the current circumstances." Sen. Collins was one of the primary authors of PAEA.

Collins went on to say, "the Postal Service's current financial condition is largely the result of its own failure to sufficiently update its business model to adapt to predictable and natural cyclical changes in the economy and mail usage."

Collins is not alone in contending that an exigent price increase is unwarranted. In a 2007 letter to the PRC, Sen. Tom Carper (D-Del.) co-authored a letter with Collins stating that the "extraordinary or exceptional circumstances" referenced in the statute establishing the procedure for an exigent rate case "may include terrorist attacks, natural disasters, and other events that may cause significant and substantial declines in mail volume."

The Affordable Mail Alliance (AMA), a coalition of associations, companies, non-profits, and local newspapers, has called on the PRC to reject USPS's price increase request. AMA believes that the Postal Service should instead focus on cutting expenses and closing redundant postal facilities.

The Postal Service maintains that recent "[p]recipitous, unprecedented and unforeseen drops in mail volume are inarguable and meet the definition and spirit of the law." In other words, USPS sees the nationwide recession as an "other event" that justifies an exigent rate case.

Office of Inspector General Attempts to Bring More Clarity to USPS Finances

The Postal Service has long guarded its financial data closely -- particularly the data related to competitive products -- complicating efforts to increase transparency for the agency's finances.

This difficulty is exemplified by a July report on the 2009 "Summer Sale" from the Office of Inspector General. The Sale offered discounts to senders of Standard Mail who reached a certain volume threshold. The report highlighted a $63.7-million discrepancy between what the Postal Service claimed to have made on the sale ($24.1 million) and what the Postal Regulatory Commission said that the agency lost thanks to the sale ($39.6 million).

The OIG is beginning to push the Service to be more transparent in its financial dealings by bolstering its Risk Analysis Research Center to undertake more in-depth studies of USPS's finances.

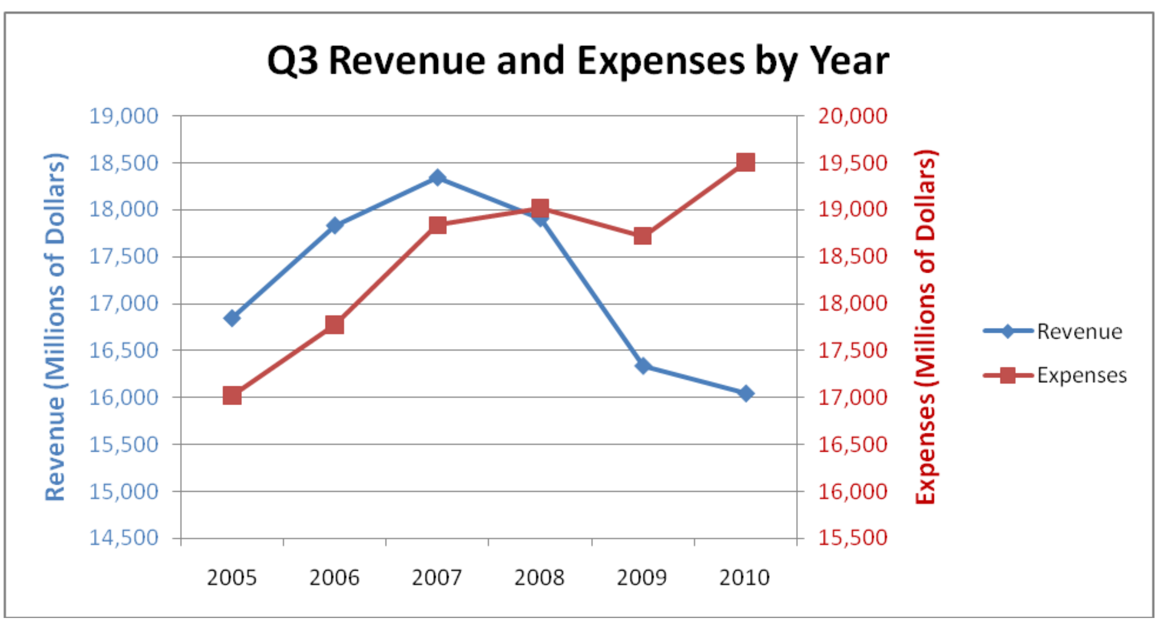
Past government reports, including one issued by the U.S. Treasury in 2007, have bemoaned the inability of the Postal Service to attribute a greater share of its costs. The OIG may be able to help advance those efforts.

Cloudy Financial Picture Hanging over Labor Negotiations

This fall, USPS begins formal contract negotiations with two of its four major labor unions. The contracts for the American Postal Workers Union (APWU), which represents 211,000 employees, and the National Rural Letter Carriers Association (NRLCA), which represents 67,000 career and 48,000 non-career employees, expire on November 20, 2010.

Given the Postal Service's precarious financial situation, the negotiations promise to be contentious. Through the first three quarters of 2010, USPS has lost $5.4 billion.

The major postal labor unions argue that the Postal Service's financial troubles are exaggerated. The National Association of Letter Carriers, for instance, is



calling on Congress to lift the retiree health benefit prefunding requirements and to refund USPS's purported overpayments to the CSRS pension fund so that the Postal Service "can operate profitably."

William Burrus, the president of the APWU, also attributes the Service's financial problems to the prefunding requirements for the Retiree Health Benefits Fund. The unions oppose legislation that would require arbitrators to consider the financial health of the Postal Service when evaluating postal contracts.

The USPS Inspector General reported that the Postal Service may have overfunded its pension obligations by $75 billion, while the Postal Regulatory Commission released a report that calculated the USPS overpayment at about $50 billion.

Negotiations will take place in the context of a national debate over disparities in compensation between comparable public- and private-sector workers. An analysis from USA TODAY found that the average federal employee is paid 20 percent more than the average private-sector worker in the same occupation.

Public-sector unions have attempted to dismiss any notion of a wage discrepancy by pointing out that many federal workers have more education and more complex jobs than private-sector workers.

Postal workers have long enjoyed a substantial wage premium over their private-sector counterparts. According to economist and postal scholar Michael Schuyler of the Institute for Research on the Economics of Taxation, the best economic research suggests that postal workers make anywhere from 25 percent to 40 percent more than comparable private-sector employees.