POSTAL TRENDWATCH

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

Postal TrendWatch
Q4FY10

Q4 FY 2010: USPS's $8.5-Billion Loss Defines Future Strategies

Executive Summary

In FY 2010, the U.S. Postal Service lost $8.5 billion -- more than its two previous annual losses combined. The Service has lost money in every quarter except one since the first quarter of 2008. Revenue for the year was down $1.04 billion, or 1.5 percent, relative to FY 2009. Total volume declined by about 6.2 billion pieces, or 3.5 percent, compared to last year. Operating expenses increased by $3.6 billion, or 5.0 percent, year over year.

Postal management has made it clear that its new products and services will be crucial to its evolving business plan. Some of these new offerings may be controversial, as they could put the Postal Service in direct competition with the private sector or into gray areas where they could potentially come into conflict with current statutory or regulatory requirements.

USPS made the scheduled $5.5-billion payment to prefund its retirees' health benefits and forecast at the end of FY 2010 that it would run out of cash and reach its statutory debt limit within a year.

Quarterly Highlights

First Class Mail volume dipped 6.6 percent compared to last year. First Class revenue declined by $1.86 billion relative to FY 2009. For the year, Standard Mail volume increased by about 77 million pieces, or 0.1 percent. In the fourth quarter alone, Standard Mail volume shot up 8.9 percent relative to the same period last year. Despite the volume increase, Standard Mail revenue was down $14 million on the year. Substantial increases in Standard Mail letter revenue and volume were offset by significant declines in revenue and volume for Standard Mail flats.

Operating expenses increased by $3.6 billion, or 5.0 percent, in FY 2010, despite the fact that work hours fell by 75 million, or 6.0 percent. USPS management attributed the increased expense levels largely to adjustments in workers' compensation obligations and the congressionally-mandated $5.5-billion payment to the retiree health benefits fund. Absent these charges, USPS reports decreasing operating expenses by $1.6 billion and a net loss of $505 million.

USPS As Government Advertising Agency?

In its recently-filed annual 10-K report for 2010, USPS stated, "Customer usage of postal services continues to shift away from transactions, correspondence, and Periodicals Mail toward advertising and Shipping Services." Postal management's strategies for adjusting the agency's business plan accordingly became increasingly apparent in 2010.

In April, the agency announced a pilot program to deliver samples of consumer packaged goods -- like beauty, health, and snack food items -- to 200,000 target consumers in Charlotte, North Carolina, and Pittsburgh, Pennsylvania. Robert F. Bernstock, the president of USPS's Mailing and Shipping Services division, said that product sampling "offers the Postal Service the potential for millions of dollars of added revenue."

To test the viability of such a service, USPS partnered with an intermediary that prepares boxes

of various product samples for the Postal Service to deliver in the test markets.

The Postal Regulatory Commission raised several issues with the product-sample program. Some of these had to do with the fact that the program chose not to charge manufacturers for including their products during the pilot. The PRC expressed dismay that the Postal Service's partners, as well as the companies whose products were being distributed, would derive benefit from the pilot program but would shoulder none of the costs, leaving them all to USPS.

The PRC also questioned whether the product-sample offering was "significantly different" than USPS's other products -- a requirement under federal law. The Commission was not convinced, pointing to a Postal Service admission that consumer packaged goods firms had previously sent product samples to consumers through existing mail channels.

> *"Increases in workers' compensation and retiree health benefits expenses more than offset the $1,896 million, or 3.7%, reduction in compensation and benefit expense in 2010."*
>
> *- 2010 Report on form 10-K, United States Postal Service, p. 14.*

Finally, the PRC asked whether the product-sample offering was truly a competitive product, as USPS claimed. Currently, product samples are typically sent via Standard Mail, which, as a market-dominant product, is subject to different statutory pricing requirements. Consumer packaged goods companies could also use competitive parcel products, if they so chose. The Commission decided to give the Service the benefit of the doubt.

The Newspaper Association of America criticized the pilot program, calling it "another example of the Postal Service attempting to influence advertising markets rather than being neutral in market competition between private-sector firms."

The NAA believes that delivery of product samples should be considered a market-dominant product and thus subject to different pricing rules. It holds that the competition lies upstream, where direct mailers, in-store displays, and newspapers sell campaigns to packaged-goods companies. USPS's offering could short-circuit this market by injecting a government enterprise to deliver consumer packaged goods products free of charge.

Parcel Select's Select Customers

In Q4 FY 2010, USPS petitioned the PRC to move Standard Mail parcels from the market-dominant category to the competitive products category, as a subset of Parcel Select.

Parcel Select, which Postal leaders tout as the agency's lowest-cost and most environmentally-friendly ground shipping option, is only available to big consolidators, large delivery companies, and freight forwarders; consumers do not have access to the service. USPS grants shippers discounts in three tiers for forwarding their packages to the lowest possible entry point within the postal network. The package is then bundled with the rest of a customer's mail for the last mile of delivery.

Parcel Select has seen major increases in volume in the past two years.

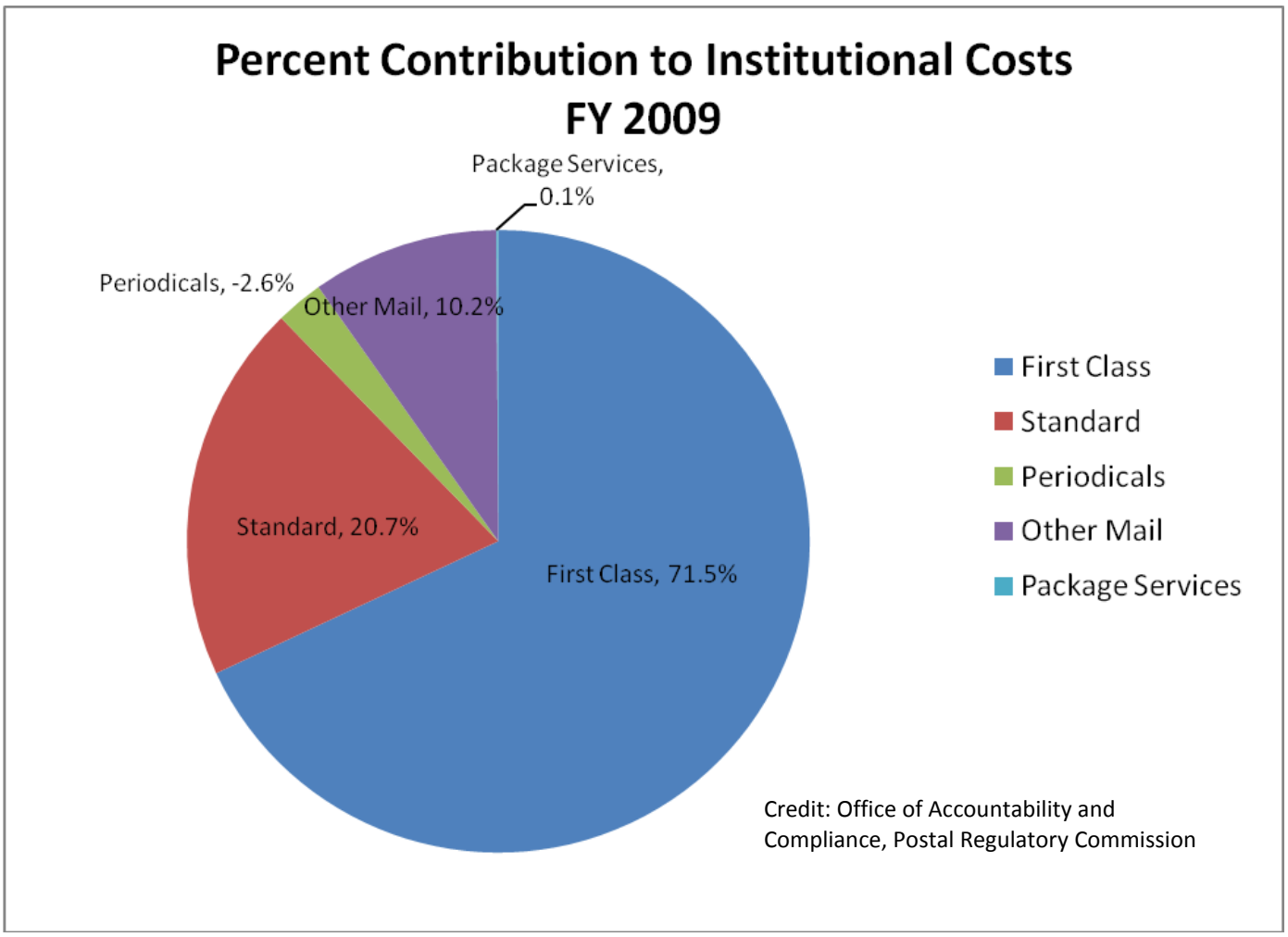
USPS requires small businesses and individuals to contract with third-party consolidators to take advantage of Parcel Select's low rates. So while the Post Office's monopoly consumers are effectively subsidizing other Postal Service offerings with lower cost coverage, their ability to take advantage of Parcel Select's attractive pricing remains extremely limited.

Issues of Cost Coverage

The debate over reclassifying Standard Mail parcels as competitive products raises questions about how much individual categories of mail contribute to institutional overhead. Because Standard Mail parcels -- which only large mailers use -- do not cover their costs, mailers who use other services, including ordinary stamp-buying consumers, effectively subsidize large private-sector shippers.

In FY 2009, contributions from First Class Mail accounted for 71.5 percent of USPS's officially-cited total overhead costs. Standard Mail was responsible for 20.7 percent of overhead. For Package Services and Other Mail, including several competitive products, the figure was just 10.3 percent. (See chart.)

The cost coverage figures reveal that ordinary stamp-buyers continue to effectively subsidize the delivery of other mail categories.



Credit: Office of Accountability and Compliance, Postal Regulatory Commission