POSTAL TRENDWATCH

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

Postal TrendWatch
Q1, FY09

Q1: USPS Starts FY2009 with Mounting Deficits

Executive Summary

The U.S. Postal Service (USPS) posted a net loss of $384 million in the first quarter of fiscal year 2009. Revenue was down by 6.3 percent -- or $1.3 billion -- compared to the same quarter last year. This comes on the heels of a $2.8 billion loss for FY2008. Mail volume decreased by 5.2 billion pieces, marking the eighth consecutive quarter of decline. Workhours decreased by 7.5 percent, which helped operating expenses fall to $19.5 billion -- a 1.1 percent decrease when compared to the first quarter of FY 2008. Lower energy prices were also a factor in the decrease in operating expenses.

Quarterly Highlights

Q1 was marked by significant declines in revenue and volume, thanks largely to the worldwide economic downturn. Postmaster General John Potter went before Congress in late January with a plan for lowering USPS operating costs. Potter proposed the elimination of one day of mail delivery per week and the postponement of benefit-funding obligations for postal retirees as prescribed in the Postal Accountability and Enhancement Act of 2006. Both proposals, particularly the switch to 5-day delivery, have met criticism.

USPS Reduces Q1 Operating Costs, But Experts Say More Serious Reforms Are Needed

In an effort to reduce operating costs, USPS cut back workhours by 27 million in Q1 FY2009. Compared with the same period last year, city delivery workhours dropped by 5.2 percent, mail processing hours by 13.2 percent, customer services workhours by 11.3 percent, and rural delivery workhours by 3.1 percent.

These cuts contributed to Q1's 1.1 percent drop in operating costs. USPS claims that the decrease in spending would have been more significant had the agency not been on the hook for record-high cost-of-living salary adjustments promised as part of national collective-bargaining agreements with the postal labor unions.

While the reductions in workhours and operating costs are a start, many believe that major facility closings are an unavoidable next step. Both Phillip Herr, director of physical infrastructure issues at the Government Accountability Office, and PRC Chairman Blair maintain that closings must be part of any serious plan for USPS's long-term financial viability.

"The Postal Service has to be more transparent about these closures," Herr said in early February. "The public needs to understand what's going to happen, and why these closures are so important."

Total factor productivity declined by 0.3 percent in Q1 FY2009. Given the precipitous decline in mail volume, this is not surprising. According to Charles Guy, Ph.D., the former director of the Postal

Preliminary Total Factor Productivity Q1 FY2009

Credit: USPS Board of Governors Financial Update, Feb. 4, 2009

	Actual
Workload	-6.6%
Resource Usage	−6.3%
Total Factor Productivity	-0.3%

Service's Office of Economics and Strategic Planning, "The drop in TFP for the first quarter is surprisingly small. USPS has done a very good job of matching the workload decline, as mail volume falls, with the reduced use of resources."

Guy predicted that it would be difficult but necessary to keep TFP declines low through the end of 2009. "To minimize the net income loss for the year, this is an extremely important task," he said.

Global Recession Blamed for Volume and Revenue Declines

USPS's mounting losses in Q1 FY2009 were attributed to economic conditions worldwide. According to the Service, the recession has adversely affected all classes of domestic mail.

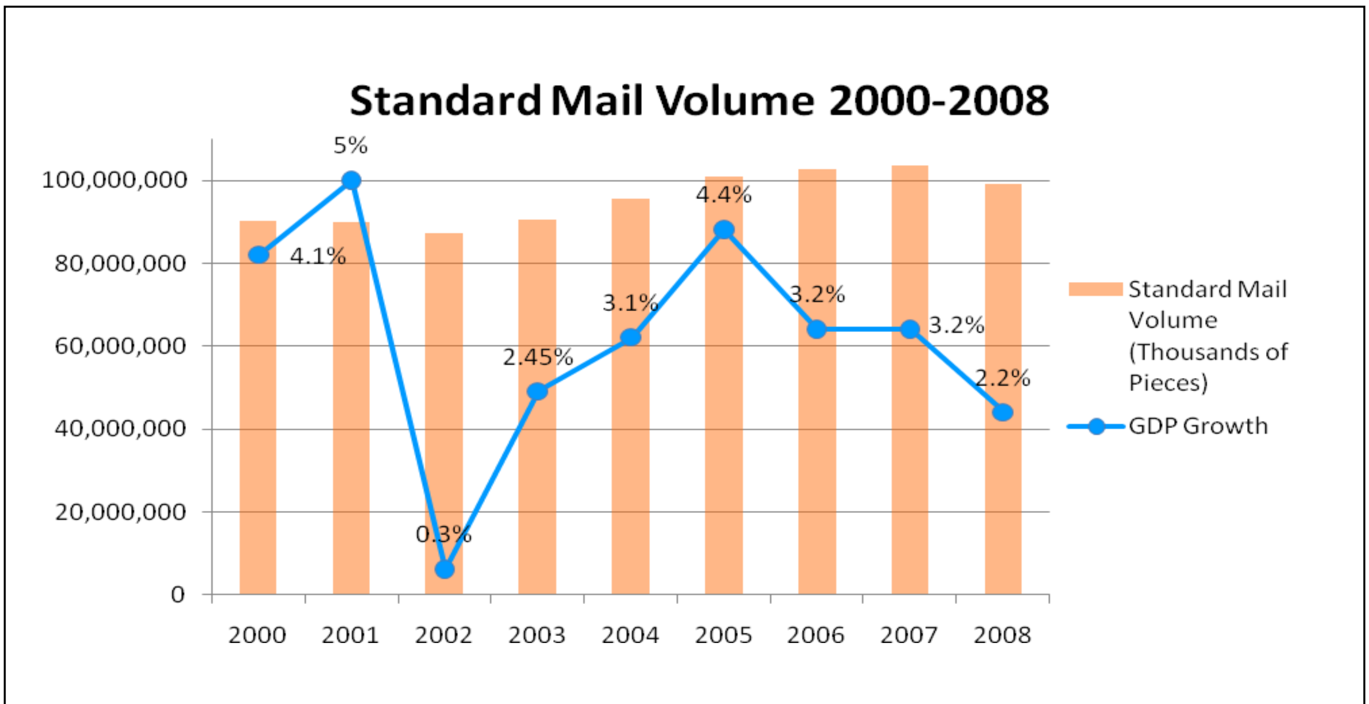
USPS posted a net loss of $384 million. Revenue was $1.3 billion lower than the same period last year. PMG Potter expects that 2008-2009 will represent the first year-to-year decline in revenue in more than 60 years.

Total mail volume declined by 5.2 billion pieces, a 9.3 percent drop from the same quarter last year. This represents the eighth consecutive quarter of accelerating volume declines. Some within the Postal Service have estimated that total volume will decrease by up to 15 billion pieces at the end of the fiscal year.

Standard Mail was hit particularly hard, dropping by 3 billion pieces this quarter when compared to the same period last year. First Class Mail volume declined by 1.8 billion pieces. Periodical volume was down by 3.5 percent and package services by 8.4 percent when compared to the first quarter of 2008.

According to Postal Regulatory Commission Chairman Dan Blair, the biggest challenge facing USPS is the decline of First Class Mail. The rise of the internet over the last decade has caused First Class volume to decline annually for the last ten years. Blair said that USPS hadn't been proactive about introducing new products to fill the gap left by First Class Mail.

The decline in Standard Mail, according to Blair, is less troubling. "Standard Mail is a good barometer for where the economy is going," Blair told the *Federal Times*. "It might come roaring back. The question is whether first-class mail will ever come back."



Postmaster General Proposes Stark Cost-Reduction Measures

Postmaster General John Potter went before Congress on January 28, 2009, to propose a series of reforms intended to reduce USPS operating costs. Paramount among them was the elimination of one day of delivery per week, which would move USPS from a six-day to a five-day weekly delivery schedule.

The idea has been panned by many members of Congress. Rep. Jose Serrano (D-N.Y.), chairman of the House Appropriations subcommittee on financial services and general government, has promised to block any legislation that moves USPS to a five-day week. Sen. Susan Collins (R-Maine) has expressed similar sentiments.

Chairman Blair also expressed concerns about the proposed change, claiming that it would "end mail as we know it." Blair explained, "Consumers rely on six-day delivery. Moreover, senders rely on it. If you don't receive the mail as often, it may not be as valuable."

Gene Del Polito, the president of the Association for Postal Commerce, said of the five-day delivery proposal, "There will be a time in the future when that has to be explored, but certainly not during [Potter's] time as postmaster general."

William H. Young, president of the National Association of Letter Carriers (NALC) has expressed serious disapproval for the move to 5-day delivery. He recently rallied NALC members against the proposal, arguing that it "would destroy tens of thousands of jobs and . . . must be resisted with all our resources."

Potter also asked Congress to amend the Postal Accountability and Enhancement Act (PAEA) to allow USPS to pay current retiree health benefits out of the Postal Retiree Health Benefits Fund not out of current operating revenue, as the law requires.

Sen. Tom Carper (D-Del.) introduced an amendment to the $787-billion stimulus package that would have granted USPS benefit-funding flexibility, but the amendment was not adopted. A consortium of business leaders and firms reliant on the mail led by the U.S. Chamber of Commerce expressed support for the Carper amendment in a letter sent to White House economic advisers on February 4, 2009.

"Consumers rely on six-day delivery. Moreover, senders rely on it. If you don't receive the mail as often, it may not be as valuable."

--PRC Chairman Dan Blair

The issue remains in play. Rep. John McHugh (R-N.Y.) has introduced a bill in the House that would grant the Postal Service the funding flexibility it has requested.

According to Potter, were it not for the retiree health benefits that USPS was obligated to pay out last year, "the Post Office would have achieved a positive net income in 2008 -- rather than our actual $2.8 billion loss." Changing the funding formula for retiree health benefits would "save the Postal Service up to $24.6 billion through 2016," Potter argued.

Notably, Potter did not express support for an exigent rate increase beyond the statutorily imposed price cap. The PAEA ordinarily limits annual rate increases to the rate of inflation but does provide for price increases beyond that cap in the event of "exigent," or extraordinary, circumstances.

"The ability of the Postal Service to continue to fulfill its universal service mission is our primary concern," PMG Potter said in his January 28, 2009, testimony to Congress. "We have targeted $5.9 billion in potential cost reductions in 2009 and 2010," he noted.