

POSTAL TRENDWATCH

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Postal TrendWatch
Q2 FY09

Q2: USPS Continues to Build Deficits

Executive Summary

The United States Postal Service (USPS) posted a net loss of \$1.9 billion in the second quarter of FY 2009, as revenue and volume declined in all mail categories. The Postal Service has posted net losses in 10 of the last 11 fiscal quarters. USPS attributes its losses to a decrease in mail volume brought on by the ailing economy. Postal Service Total Factor Productivity dropped by 2.0% in 2Q09 -- one of the sharpest declines in TFP in the last decade. The chart on page 3 illustrates some concerning trends in USPS productivity.

On May 11, USPS enacted price increases on First Class Mail, domestic postcards, parcels, large envelopes, and international mail. Despite the price increases, USPS projects a year-end budget deficit of nearly \$6 billion by the end of 2009. The agency has continued to show renewed interest in broadening its product line in order to become financially viable.



Quarterly Highlights

Standard Mail experienced a sharp decline in revenue of nearly a \$1 billion this quarter in comparison to the same quarter in 2008. First Class Mail volume was down nearly 10 percent compared to the same period last year, and Standard Mail volume was down by nearly 20 percent. The losses incurred by USPS through six months of FY 2009 are now almost as high as the losses from all of FY 2008.

Spiraling Declines in Volume and Revenue Continue

Steep declines in usage and revenue have, for months, been blamed on the recession. And 2Q09 was no different. According to Postmaster General John Potter, "The economic recession has been tough on the mailing industry, and we have seen an unprecedented decline in mail volumes and revenue that continued to accelerate during the second quarter."

This quarter's declines were unusually severe. USPS's total volume declined 14.7 percent in 2Q09, to 43.8 billion pieces, when compared to the same period last year. That's the largest quarterly drop since Postal Reorganization in 1971. And the \$1.9 billion net loss incurred this quarter is a full 169 percent higher than the losses for 2Q08. On top of that, the Postal Service's year-to-date operating losses of \$2.3 billion are about a hundred times bigger than they were this time last year.

Compared to 2Q08, the starkest drop in volume was for Standard Mail, which declined 4.9 billion pieces this quarter, a change of nearly 20 percent. First Class Mail volume dropped more than 2.3 billion pieces. Meanwhile, volume for periodicals was down 169 million pieces.

"The Postal Service must rely on cost-cutting and efficiency measures to deal with its current financial difficulties."

**-- John Waller, Director, PRC
Office of Accountability and
Compliance**

One important consequence of the reduction in USPS's workload was a decline in productivity. Despite an 8.3 percent drop in workhours, the Postal Service's Total Factor Productivity decreased by 2 percent compared to the same period last year.

Declines in revenue were severe across all categories of mail. First Class revenue was down by \$762 million compared to the same period last year, while Standard Mail suffered the largest decline of all categories -- \$988 million. Revenue from periodicals was down \$65 million, and package mail revenues dropped by \$35 million. USPS is on pace for a \$1.5 billion cash shortfall by the end of the year.

Electronic Diversion: The Other Culprit

Postal Service management also cited increase use of electronic methods of correspondence for the second quarter's volume and revenue drop-offs. In this quarter, the growing trend of electronic filing of tax returns and electronic deposit of tax refunds hit USPS particularly hard. According to the USPS 10-Q report, "In Quarter II the largest decline in First-Class Mail volume came from the U.S. Treasury,

mostly the Internal Revenue Service." Indeed, this year the number of people e-filing their taxes increased by 16.7 percent.

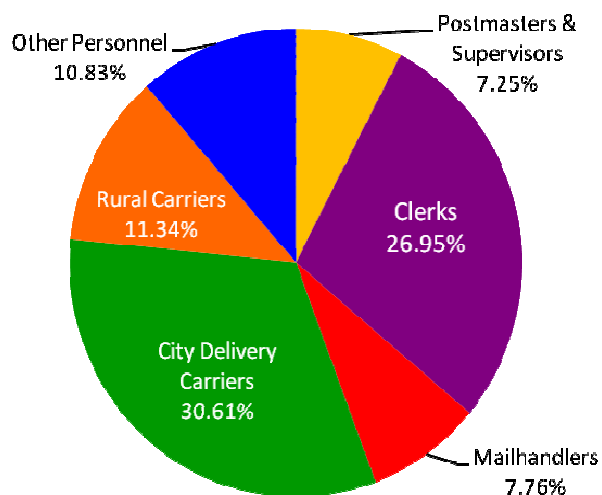
USPS also cited the increased availability of periodicals on the internet and the abandonment of print versions by several magazines as reasons for volume declines.

Composition of Postal Labor Force Continues to Shift

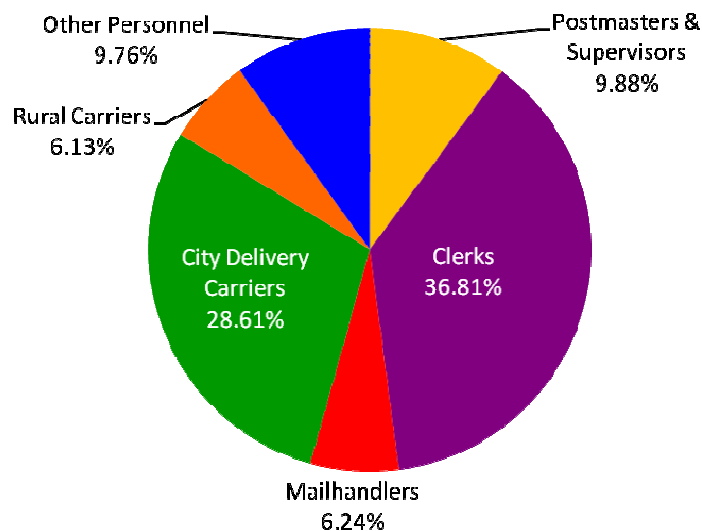
During 2Q09, the Postal Service reduced its workforce by about 15,000. USPS currently has 641,438 career employees on its rolls.

The charts below illustrate the changing composition of the USPS labor force. Of particular note is the rapid decline in the percentage of total compensation attributed to clerks between 1988 and 2008. At the same time, letter carriers' share of total compensation has grown substantially. The percentage attributed to rural letter carriers has doubled, while the share for city letter carriers is now the largest of any employee category.

Percentage of Total Labor Compensation 2008



Percentage of Total Labor Compensation 1998



USPS Looking to Branch Out

In light of the agency's poor economic performance, postal leaders have called on USPS to branch into new services in an attempt to find new revenue opportunities. Earlier this year, Postal Regulatory Commission Chairman Dan Blair expressed disappointment that the Postal Service had not been aggressive enough in introducing new products. Postmaster General John Potter has suggested repeatedly that USPS would look to introduce new products to grow revenue.

As part of this plan, the Postal Service has been working to expand its market share in domestic package shipping, particularly since DHL has stopped delivering domestically. It's unclear if USPS's effort has worked. Package services volume and revenue declined in 2Q09, but the category suffered the least severe drops.

In May, the Postal Regulatory Commission approved a Postal Service proposal to run a 2-year market test for a competitive, less-than-truckload shipping service called "Collaborative Logistics." It is also planning a much-discussed "summer sale" to provide temporary price reductions for mailers whose volume exceeds historical norms or expectations.

In testimony before the House Subcommittee on Federal Workforce, Postal Service and the District of Columbia in May, John Waller, the Director of Office of Accountability and Compliance at the Postal Regulatory Commission, noted, "The [Postal Regulatory

Commission continues to encourage the Postal Service to use its new pricing flexibilities to develop new products, increase revenue and grow mail volume." But he warned that in the short term, "the Postal Service must rely on cost-cutting and efficiency measures to deal with its current financial difficulties."

Waller noted that the Postal Service's plans for maintaining solvency this year are "contingent" on "nearly \$6 billion in cost savings and utilizing its maximum \$3 billion borrowing authority."

The push for new products is nothing new. In fact, USPS has a long history of introducing new products and services -- with relatively dismal results. The Postal Service's failed Online Payment Services experiment -- launched with great fanfare in the late 1990s -- lost more than \$10 million in FY 2001. Mailing Online, a web-based service for sending snail mail, lost \$30 million between 2001 and 2003.

The Postal Service's marketing experiments have also demonstrated mixed results. For instance, USPS spent between \$9 and \$10 million a year to sponsor cyclist Lance Armstrong in the Tour de France in the late 1990s and early 2000s as part of an effort to increase sales of global postal products and to break into key international markets. But the campaign failed, as revenues from USPS's international operations were \$12.3 million lower in 2003 than they were in 1999.

TFP Change from the Same Period the Previous Year

