

# United States Postal Service: A Sustainable Path Forward

Report from the Task Force on the  
United States Postal System



DECEMBER 2018

# **United States Postal Service: A Sustainable Path Forward**

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the United States Postal System

*December 4, 2018*





DEPARTMENT OF THE TREASURY  
WASHINGTON, D.C.

December 4, 2018

The Honorable Donald J. Trump  
The White House  
Washington, DC

Dear Mr. President:

On April 12, 2018, you signed Executive Order 13829, which established the Task Force on the United States Postal System to evaluate the operations and finances of the United States Postal Service (USPS) and develop recommendations for administrative and legislative reforms for the U.S. postal system. The goal of these recommendations is to identify a path for the USPS to operate under a sustainable business model, providing necessary mail services to citizens and businesses, while competing fairly in commercial markets.

The Task Force conducted extensive outreach to stakeholders and performed in depth research and analysis in order to understand the wide range of challenges facing the USPS.

In addition to our August 10, 2018, submission, the Task Force presents here its findings and full list of recommendations. We believe these are the first steps forward in creating a sustainable business model under which the USPS can continue to provide necessary mail services for all Americans.

Sincerely,

Steven T. Mnuchin  
Secretary of the Treasury  
Chairman, Task Force on the United States Postal System

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# Executive Summary

## A. Task Force on the United States Postal System

On April 12, 2018, President Donald J. Trump created the Task Force on the United States Postal System. The Task Force is chaired by the Secretary of the Treasury and includes the Director of the Office of Management and Budget and the Director of the Office of Personnel Management. The Task Force was directed to evaluate the operations and finances of the United States Postal Service (USPS) and submit findings and recommendations to the President.

The Task Force conducted a robust analysis of the USPS's operations and finances that was informed by an extensive review of information provided by the USPS, academic literature, and industry studies; a review of legislative history and meetings with members of Congress and the Congressional committees of jurisdiction; and meetings with a wide range of stakeholders. Per the Executive Order, the Task Force studied:

- i. The expansion and pricing of the package delivery market and the USPS's role in competitive markets;
- ii. The decline in mail volume and its implications for USPS self-financing and the USPS monopoly over letter delivery and mailboxes;
- iii. The definition of the "universal service obligation" in light of changes in technology, e-commerce, marketing practices, and customer needs;
- iv. The USPS's role in the U.S. economy and in rural areas, communities, and small towns; and
- v. The state of the USPS business model, workforce, operations, costs, and pricing.

The recommendations of the Task Force, presented within this document, promote commerce and communications throughout the United States, without shifting additional costs to the taxpayers, and include proposed administrative and legislative reforms to create a sustainable business model for the USPS.

### Outreach and Research

The Task Force met with a wide range of stakeholders representing the USPS workforce; commercial, non-profit, and residential users of the USPS's services; and the USPS's suppliers and competitors. A list of organizations and individuals that provided input to the Task Force in connection to this report appears in Appendix B.



As directed by the Executive Order, the Task Force consulted with the Postmaster General; the Chairman of the Postal Regulatory Commission (PRC); the Attorney General on issues relating to government monopolies operating in the commercial marketplace; the Secretary of Labor on issues relating to workers' compensation programs; and state, local, and tribal officials. The Task Force also conducted a thorough review of data, research, and published material from public and private sources, including from the USPS, the U.S. Government Accountability Office (GAO), and the USPS Office of Inspector General (OIG).

### **B. Unsustainable Financial Path**

The USPS is a \$71 billion enterprise that collects, processes, transports, and delivers 146 billion pieces of mail and packages to nearly 159 million households and businesses annually.<sup>1</sup> The mission of the USPS is broadly defined via the “universal service obligation” (USO), which is intended to ensure that all citizens and businesses in the United States receive a minimum level of postal services at a reasonable price.

The USPS has been losing money for more than a decade and is on an unsustainable financial path. The USPS is forecast to lose tens of billions of dollars over the next decade. Further, as of the end of FY 2018, the USPS balance sheet reflects \$89 billion in liabilities against \$27 billion in assets – a net deficiency of \$62 billion.<sup>2</sup>

The shift toward digital correspondence and the corresponding decline in USPS mail volumes have been compounded by caps on mail pricing, leading to mail revenue declines of around 4 percent per year. Additionally, the USPS has not been able to sufficiently reduce costs to offset declines in revenue, resulting in net losses totaling \$69 billion between FY 2007 and FY 2018.

Although package volumes are increasing due to the rise of e-commerce, package revenues alone cannot offset the decline in mail revenues. Additionally, as the USPS delivers more packages, it is competing with private delivery companies and distorting overall pricing in the package delivery market.

The USPS's business model – including its governance, product pricing, cost allocation, and labor practices – was sustainable in an era where mail revenues and volumes grew alongside population and economic growth. However, as the USPS's financial condition continues to deteriorate, standalone proposals, such as forgiving the prefunding of post-employment benefits or renegotiating labor contracts, will be insufficient. The USPS's ability to achieve and maintain sustainability over the long-term is dependent upon formative reforms to its

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<sup>1</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>2</sup> Ibid.

business model that will enable it to flexibly and swiftly adapt to the social, technological, and operational changes in the mail and package markets.

### **C. Scope of Work**

The Task Force's review of the U.S. Postal System identified significant opportunities for reform that would enable the USPS to operate a sustainable business model and compete fairly in competitive markets. The Task Force considered both administrative and legislative reforms that take into account changes in the postal industry, the USPS's competitive advantages, and areas requiring improvement through either government or private sector-driven initiatives. This report provides options that should be considered, in whole or in part, as the USPS and other stakeholders work to evolve the USPS's business model and restore it to the long-term sustainability demanded of it by the American people.

The Task Force also considered the USPS's particular importance to rural and remote locations within the United States, recognizing the USPS's role in the U.S. economy, as both a service provider and employer. The USPS provides postal services across all regions and is one of our nation's largest employers, with employees in nearly every community in the country. The Task Force strongly believes that any potential solutions considered should not disadvantage those living in rural or remote locations.

Finally, as international mail and packages play a relatively small role in the overall economic performance of the USPS, representing 3.7 percent of total USPS revenue,<sup>3</sup> this report does not specifically address issues associated with the shipment and receipt of international mail and packages. However, the Task Force fully supports the August 23, 2018 Presidential Memorandum that instructed the Secretary of State to seek reforms to the Universal Postal Union (UPU) to achieve a system of fair and nondiscriminatory postal rates, and strongly supports the State Department's October 17, 2018 notice of denunciation that begins the year-long process of United States withdrawal from the UPU. The Task Force is also pleased with the October 24, 2018 passage of the STOP Act, which will require the USPS to adopt advance electronic data for international mail shipments in order to help stop the flow of fentanyl, and other illegal shipments, into the United States via the USPS.

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<sup>3</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

## D. Summary of Recommendations

The Task Force’s recommendations align with the following operating realities of the postal system:

- The volume of First-Class and other mail is in decline;
- Initiatives must be taken to address both the USPS’s revenues and costs; and
- Optimizing the unique franchise and monopoly value of the system is necessary.

The Task Force recommends that the USPS and Congress work to overhaul the USPS’s business model in order to return it to sustainability. Both administrative and legislative actions are needed to ensure that the USPS does not face a liquidity crisis, which could disrupt mail services and require an emergency infusion of taxpayer dollars. The following provides a summary of the Task Force’s recommendations. A full list of recommendations can be found in Appendix A.

### *Governance*

The USPS suffers from a lack of institutional governance. The USPS’s Governors are considered the “head of the agency” and are responsible for directing and controlling the USPS. Between December 2016 and August 2018, the USPS Board of Governors (the Board) had no Governors. In August 2018, the Senate confirmed two Governors – the first Governors confirmed by the Senate since 2010. Without Governors, the Postmaster General managed the USPS’s financial and operational challenges without strategic direction and guidance, exacerbating management’s limited power to effect needed organizational change. The Board should move to create a new policy mandate that resets the USPS’s organizational direction and develops financial targets for the USPS. Governance should be strengthened with expanded Board controls and increased accountability. Moreover, if the USPS is unable to achieve a sustainable business model and satisfy its financial commitments, including those to other federal agencies, the PRC should be given stronger regulatory authority to take necessary revenue and expense measures.

### *Universal Service Obligation*

The USO is a public policy that defines what citizens and businesses need from a government provided postal service, representing a mission statement for a country’s postal system. The generally accepted attributes for defining the USO include specifying the geographic coverage for postal delivery, frequency of delivery, processing standards, mode of delivery, range of required postal products, level of access to post offices, and rules for affordable postal rates.

In the United States, the USO is not clearly defined. For the USPS’s business model to achieve sustainability, the USO must be defined with greater specificity. The Task Force believes that the USO must distinguish between the types of mail and packages for which a



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strong social or macroeconomic rationale exists for government protection in the form of price caps and mandated delivery standards (“essential services”), versus those types of mail and packages that are commercial in nature, and therefore would not have a basis for government protection. This definition will provide the USPS and the PRC with a framework to sustainably manage pricing, costs, and products.

### *Pricing*

With the rise of digital alternatives and the corresponding decline in mail volumes, across-the-board rate caps on mail products have become an obstacle to the USPS’s financial sustainability. Although the USPS does have pricing flexibility within its package delivery segment, packages have not been priced with profitability in mind. The USPS should have the authority to charge market-based prices for both mail and package items that are not deemed “essential services.” This will allow the USPS to optimize its income in order to fund its operations, capital expenditures, and long-term liabilities.

### *Cost Allocation*

The USPS’s current cost allocation methodology is outdated, leading to distortions in investment and product pricing decisions. The USPS’s current cost methodology does not take into account that market dominant and competitive products operate under different regulatory and market rules, nor does it capture the cost implications that the rapid decline in mail volume and the rapid rise of package volume have had on the USPS’s cost structure. Modernizing the USPS’s cost standards and allocation methodology is a key principle needed to reform the USPS. This modernization will provide the USPS the information it needs to inform critical management decisions, government policies, and regulatory reporting.

### *Operating Costs*

In order to move towards a path of sustainability, the USPS must also address its rising labor and operating costs, including capital expenditures. The USPS’s operating costs are expected to continue to grow as the country’s population expands, new delivery points are added, and as the requirements for package delivery increase. The USPS must pursue new cost-cutting strategies that will enable it to meet the changing realities of its business model. These should include evaluating modifications to delivery processing standards, and the expanded use of private sector partners in areas such as processing and sortation.

### *Labor Model*

In FY 2018, labor costs accounted for 76 percent of the USPS’s overall operating costs.<sup>4</sup> Consistent with the President’s Management Agenda to modernize the government workforce, the Task Force recommends that the USPS more closely align wages for both its career and non-career workers with those of other federal employees, drawing from like examples in the broader labor market.

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<sup>4</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

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### *Retiree Health Benefits*

Congress requires the USPS to fund the retiree health benefits of its employees as part of a mandate for postal self-sustainability. The Task Force does not believe that this general policy should change or that the liability for USPS retiree health benefits should be shifted to the taxpayers. The Task Force believes that this obligation, including the \$43 billion in pre-funding payments that the USPS failed to pay into the Postal Service Retiree Health Benefits Fund and the unfunded actuarial liability for retiree health benefits, must be restructured with the payments re-amortized with a new actuarial calculation based on the population of employees at or near retirement age.<sup>5</sup>

### *New Revenue Streams*

The USPS should explore new business opportunities that will allow it to extract value from its existing assets and business lines. For example, the USPS should explore licensing access to the mailbox and providing additional government services, such as licenses for hunting and fishing. The USPS could also capture additional value from its existing retail offices by converting post offices into contract post offices or by co-locating with or renting space to complementary retail establishments. However, given the USPS's narrow expertise and capital limitations, USPS should not pursue expanding into new sectors, such as postal banking, where the USPS does not have a demonstrated competency or comparative advantage, or where balance sheet risk would be added.

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<sup>5</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

## Introduction

### A. History of the United States Postal Service

Over the last two hundred years, the United States Postal Service (USPS) has provided “postal services to bind the Nation together through the... correspondence of the people.”<sup>6</sup> The nature of postal services in the United States has varied over time, but has trended towards higher levels of service.

#### Early Days

Prior to 1863, there was limited delivery of mail. Americans generally had to pick up mail at their local post offices. Long lines resulting from Civil War correspondence triggered the start of free mail delivery in cities and resulted in the first uniform nationwide rate for First-Class Mail.<sup>7</sup> In 1902, after years of pressure from farmers and other rural Americans, rural delivery became a permanent service of the Post Office Department.<sup>8</sup> The extension of mail delivery to rural Americans prompted calls for the Post Office to deliver packages as well. The 1913 appropriations act for the Post Office Department created “fourth-class mail matter” that included packages “not exceeding eleven pounds in weight, nor greater than seventy-two inches in length and girth combined...”<sup>9</sup> Within the first six months of offering this service, 300 million parcels were delivered.<sup>10</sup> Parcel Post, as it was called, spurred dramatic growth of the mail order business, with Sears, Roebuck and Company experiencing a five-fold increase in orders in just one year.<sup>11</sup>

#### 1970 Postal Reorganization Act

By the 1960s, the business model for the Post Office Department began to break down. Congress set postal rates and annually appropriated funds for the Department, with 20

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<sup>6</sup> 39 U.S.C. § 101(a).

<sup>7</sup> United States Congress. Thirty-Seventh Congress. Session III. Chap. 71 - *An Act to amend the Laws relating to the Post-Office Department* (March 3, 1863), Sec. 19, available at: <https://www.loc.gov/law/help/statutes-at-large/37th-congress/c37.pdf>.

<sup>8</sup> United States Postal Service, *Publication 100: An American History 1775-2006*, (November 2012), available at: [https://about.usps.com/publications/pub100/pub100\\_024.htm](https://about.usps.com/publications/pub100/pub100_024.htm).

<sup>9</sup> United States Congress. Sixty-Second Congress. Session II. Chap. 389 - *An Act making appropriations for the service of the Post Office Department for the fiscal year ending June thirtieth, nineteen hundred and thirteen, and for other purposes* (August 24, 1912), Sec. 8, available at: <https://www.loc.gov/law/help/statutes-at-large/62nd-congress/session-2/c62s2ch389.pdf>.

<sup>10</sup> United States Postal Service, *Publication 100: An American History 1775-2006*, (November 2012), available at: [https://about.usps.com/publications/pub100/pub100\\_024.htm](https://about.usps.com/publications/pub100/pub100_024.htm).

<sup>11</sup> Ibid.

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percent of the Department's operating budget coming from a direct taxpayer subsidy.<sup>12</sup> Postal facilities were woefully out of date, and the low pay for postal employees, mandated by Congress, meant that many postal employees in urban areas were paid at or near the poverty level.<sup>13,14</sup> Labor relations and modernization failures proved intractable, as there was little political will in Congress to provide additional funds for either pay increases or capital expenditures.

Two examples showcase the magnitude of the problems. In October 1966, the world's largest postal facility, the Chicago Post Office, was overwhelmed by 10 million pieces of mail and was forced to shut down for three weeks so that it could clear its mail backlog.<sup>15</sup> In 1970, labor discontent over compensation ultimately led to a "wildcat" strike that involved 200,000 postal workers, and only ended after postal management and the Nixon Administration made commitments to provide retroactive raises and legislative reform.<sup>16</sup>

In 1967, President Johnson formed a Commission on Postal Organization, the "Kappel Commission," to examine the Department. The Commission's findings served as the basis for the 1970 Postal Reorganization Act (PRA).<sup>17</sup> This law (1) created the new USPS as an independent establishment of the executive branch of the government; (2) established a Board of Governors, who would select the Postmaster General; (3) directed USPS to become a self-funded entity, without a taxpayer subsidy; (4) retained postal employees as members of the civil service, but permitted postal unions to bargain over wages and benefits; and (5) established a new Postal Rate Commission to review and make recommendations on postal rates.<sup>18</sup>

### 2006 Postal Accountability and Enhancement Act

Thirty years after the PRA, the USPS had again come to a crossroads. As summarized by President Bush's 2003 Commission on the United States Postal Service:

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<sup>12</sup> Report of the President's Commission on Postal Organization entitled "toward postal excellence," (1968) [prepared for] Committee on Post Office and Civil Service, House of Representatives, Ninety-fourth Congress, second session, November 24, 1976, p. 1–6, available at: <http://ufdc.usf.edu/A400024775/00001/9j>.

<sup>13</sup> Cordtz, D., "It's Now or Never for the Post Office," *Fortune*, (March 1967), p. 134-136.

<sup>14</sup> Chaifetz, Richard I., *The Postal Reorganization Act: Applying the Law to the Letter*, 12 B.C.L. Rev. 1151 (1971), available at: <https://lawdigitalcommons.bc.edu/bclr/vol12/iss6/5>.

<sup>15</sup> Boyd, D., & Chen K., "The History and Experience of African Americans in America's Postal Service, Chicago: A Postal Shutdown," *Smithsonian National Postal Museum*, available at: <https://postalmuseum.si.edu/AfricanAmericanhistory/p10.html>.

<sup>16</sup> Ibid.

<sup>17</sup> P.L. 91-375, available at: <https://www.gpo.gov/fdsys/pkg/STATUTE-84/pdf/STATUTE-84-Pg719.pdf>.

<sup>18</sup> Ibid.

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*The traditional mail stream will likely continue to migrate to cheaper Internet-based alternatives. Largely as a result, the Postal Service will increasingly find it difficult to meet its “break-even” mandate... [E]ven if postage rates continue to adjust for inflation, the Postal Service, over the next 15 years is likely to run substantial deficits. Equally discouraging, these obligations would pile on top of the Postal Service’s \$92 billion in current debt and other unfunded obligations. Without significant modernization, the Postal Service will have three choices: dramatically roll back service, seek a rate increase of unprecedented scale, or fall even further into debt, potentially requiring a significant taxpayer bailout.<sup>19</sup>*

In response to these challenges, Congress enacted the 2006 Postal Accountability and Enhancement Act (PAEA). PAEA made four major changes to the USPS: (1) products were divided into monopoly (mainly mail products) or competitive (generally packages and express mail) products; (2) monopoly product rate increases were capped at the growth of the consumer price index for urban consumers (CPI-U); (3) the USPS was given latitude to set rates on competitive products, as long as competitive product revenue met certain minimum cost coverage thresholds; and (4) the USPS was required to begin prefunding accrued retiree health benefit liabilities.<sup>20</sup>

A goal of PAEA was to push the USPS to find opportunities to improve its finances through increased efficiency, rather than through rate increases, thereby mitigating future negative impacts from mail volume declines.<sup>21</sup> These changes were intended to put the USPS on a more stable long-term footing, given the expectation of declines in mail volumes.

### **B. Role of the USPS in the Economy**

The role of the USPS in the economy is set forth by Congress in federal statute:

*The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt,*

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<sup>19</sup> President’s Commission on the United States Postal Service, *Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service*, (July 31, 2003), available at: <http://govinfo.library.unt.edu/usps/offices/domestic-finance/usps/pdf/freport.pdf>.

<sup>20</sup> United States Postal Service, *Publication 100: An American History 1775-2006*, (November 2012), available at: [https://about.usps.com/publications/pub100/pub100\\_024.htm](https://about.usps.com/publications/pub100/pub100_024.htm).

<sup>21</sup> United States Congress. Committee on Government Reform. 109<sup>th</sup> Congress. 1<sup>st</sup> Session. Report to accompany H.R. 22., Rept No. 109-66, Committee Statement and Views, available at: <https://www.congress.gov/congressional-report/109th-congress/house-report/66>.

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*reliable, and efficient services to patrons in all areas and shall render postal services to all communities.*<sup>22</sup>

To fulfill this mission, the USPS provides postal services to commercial, non-profit, and residential users across all regions of the United States. The USPS has been granted two statutory monopolies. The first is to carry, collect, deliver, and receive letters over regular postal routes (the letter delivery monopoly). The second is for the delivery of mail and packages into mailboxes, effectively granting the USPS exclusive access to mailboxes (the mailbox monopoly).<sup>23</sup> These monopolies give the USPS exclusive rights to most letter deliveries and provide it with an advantage in the small package delivery market.

Given these monopolies, the USPS is a significant participant in the broader mailing industry that includes manufacturers, mail preparers, shippers, and other delivery companies. Moreover, the USPS is one of the largest employers in the United States with 634,000 career and contract workers.<sup>24</sup> If it were a private sector company, the USPS would rank 40th in the 2018 Fortune 500 and 123rd in the 2017 Global Fortune 500.<sup>25</sup>

### The USPS as a Service Provider

In FY 2018, USPS delivered 146 billion pieces of mail to 159 million delivery points, including to rural and remote locations.<sup>26</sup> Private carriers charge many of these locations a delivery surcharge, limit the services offered to these locations, and in a few cases, offer no service at all. No other domestic delivery service comes close to the comprehensive network and frequency of delivery offered by the USPS.

Households are by far the biggest user of the USPS – approximately 83 percent of USPS volume (mail and packages) is sent either to or from households.<sup>27</sup> The most common type of household mail (62 percent) is advertising mail, which includes promotional and sales material.<sup>28</sup> The bulk of advertising mail is sent by merchants and financial firms, which consider mail a better medium to track response rates than other types of media. However, the rise of Internet advertising has left mail with a shrinking share of total U.S. advertising

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<sup>22</sup> See 39 U.S.C. § 101(a).

<sup>23</sup> See 18 U.S.C. § 1725.

<sup>24</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>25</sup> Ibid.

<sup>26</sup> Ibid.

<sup>27</sup> United States Postal Service. *The Household Diary Study: Mail Use and Attitudes in FY 2017*, (March 2018), available at: [https://www.prc.gov/docs/105/105134/USPS\\_HDS\\_FY17\\_Final%20Annual%20Report.pdf](https://www.prc.gov/docs/105/105134/USPS_HDS_FY17_Final%20Annual%20Report.pdf).

<sup>28</sup> Ibid.



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spending. Mail fell from 12 percent of advertising spending during the 1990s and 2000s to 9 percent in 2017.<sup>29</sup>

The second most common type of household mail (31 percent) is correspondence and transactional mail.<sup>30</sup> Correspondence mail includes letters, greeting cards, invitations, and announcements. Transactional mail includes bills, statements, payments, donations, rebates, and orders. The largest senders of correspondence and transactional mail are financial and insurance firms, utility companies, healthcare providers, and government agencies, such as the Social Security Administration and the Internal Revenue Service. The rise of email, online payments, and e-statements has caused a precipitous decline in correspondence and transactional mail. First-Class Mail, which facilitates most of these transactions, experienced a volume decline of 42 percent between 2007 and 2018.<sup>31</sup>

Periodicals (newspapers and magazines) represent 3.9 percent of the household mail volume.<sup>32</sup> Most periodicals are sent by commercial institutions, but educational, philanthropic, and religious and other nonprofit organizations also use this medium and receive discounted mailing rates that are not offered by private carriers. Periodicals have declined almost every year since 1990, driven by a declining readership and an increasing number of publications that have ceased operations.

While mail use has declined, demand for package delivery has increased sharply due to the rise of e-commerce. USPS package volume grew significantly between 2008 and 2018. Most USPS package deliveries are household orders of clothing, pharmaceuticals, household products, and books.<sup>33</sup> The USPS increasingly competes with other package carriers in high-volume urban markets. However, it remains an important service provider in the package delivery market due both to its accessibility to all addresses across the United States and the capacity constraints of private carriers, especially during peak times, such as around the holidays.

### The USPS as a “Value Chain” Participant

The mail industry value chain consists of: origination, receipt, transportation, processing and delivery (see Figure 1).

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<sup>29</sup> Ibid.

<sup>30</sup> Ibid.

<sup>31</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW)* reports 2007-2018, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>32</sup> United States Postal Service. *The Household Diary Study: Mail Use and Attitudes in FY 2017*, (March 2018), available at: [https://www.prc.gov/docs/105/105134/USPS\\_HDS\\_FY17\\_Final%20Annual%20Report.pdf](https://www.prc.gov/docs/105/105134/USPS_HDS_FY17_Final%20Annual%20Report.pdf).

<sup>33</sup> Ibid.

Figure 1: Mail "Value Chain"



*Origination* includes the design and printing of mail, processes in which the USPS is not directly involved. *Receipt* (also known as collection, pick-up, or “first mile”) refers to the collection of mail and involves multiple points of entry, including post offices, USPS owned processing centers, drop boxes, and household mailboxes.

*Transportation* refers to the shipment of mail between collection points, processing facilities, and delivery facilities via truck, air, and rail. While the USPS operates its own intra-city transportation, it also leverages third-party long-haul service providers. The USPS contracts directly for air and inter-city truck transportation for both mail and packages. In FY 2018, USPS spent over \$7.9 billion (11 percent of operating expenses) on purchased transport, the second largest expense after personnel costs.<sup>34</sup>

*Processing* (or sortation) of mail involves the automated and manual sorting of mail into geographic units (region, state, 3-5-digit zip code, and carrier route). Depending on the specific mail product, volume levels, and mailer sophistication, either the USPS or third-party mail service providers (MSPs) will process the mail in their respective networks for transport to a postal facility for final delivery.

Finally, *delivery* of mail (also known as “last mile”) involves the shipment of mail from a USPS delivery unit (such as a post office) to its destination.

The participants in the value chain differ somewhat between mail and packages. In the mail value chain, the USPS works closely with MSPs and contracts with transportation providers to provide key services and processes. MSPs provide origination, processing, and transportation services, bringing bulk mail close to the final delivery stage where it is transferred to the USPS at discounted postage rates for delivery.<sup>35</sup> In FY 2014, the USPS reported over \$29 billion in revenue from MSPs.<sup>36</sup>

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<sup>34</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>35</sup> Ibid.

<sup>36</sup> United States Postal Service, Office of Inspector General, Report Number MS-WP-15-003, *Mail Service Providers*, (August 31, 2015), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2015/ms-wp-15-003.pdf>.

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In the package market, the USPS competes with private industry in package pickup, processing, transportation, and delivery. In the United States, the package market is dominated by three major carriers: United Parcel Service (UPS), Federal Express (FedEx), and the USPS, but also includes regional carriers and other smaller service providers. For competitive end-to-end package delivery in FY 2016, UPS had a 40 percent market share, FedEx had a 30 percent market share, and the USPS had a 17 percent market share by revenue.<sup>37,38,39</sup> Despite its smaller overall market share, the USPS plays an especially important role in the delivery of lightweight packages to households. It also handles much of the “last mile” delivery for other carriers, as it visits every address at least six days per week.

The USPS operates the nation’s largest retail network and has one of the largest vehicle fleets in the country.<sup>40,41,42</sup> As part of the mail and package value chain, the USPS is linked to economic activity beyond its delivery functions. The value chain can include manufacturers of mail and package processing equipment, delivery vehicles, and mailboxes. The unique role of the USPS within the value chain is to provide regular delivery to every household in the United States.

### The USPS as an Employer

The USPS is one of the largest employers in the United States. In FY 2018, it paid \$56.9 billion in wages and benefits and employed 497,000 career employees and 137,000 non-career employees.<sup>43</sup> The overwhelming majority of these are field employees – meaning the USPS has an employment footprint in nearly every community in the country.

The typical postal service worker earns a higher wage than the average U.S. worker. However, postal workers note that their salaries must be compared to those of their major competitors, UPS and FedEx, rather than the typical U.S. worker. This calculation is difficult given the need to adjust for similar experience, duties, and location as well as the lack of detailed data on wages and benefits within these companies. Based on Treasury staff

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<sup>37</sup> United States Postal Service, *Public Cost and Revenue Analysis FY 2016*, available at: <https://about.usps.com/who-we-are/financials/cost-revenue-analysis-reports/fy2016.pdf>.

<sup>38</sup> Federal Express, *FedEx Annual Report 2016*, available at: [http://s1.q4cdn.com/714383399/files/doc\\_financials/annual/FedEx\\_2016\\_Annual\\_Report.pdf](http://s1.q4cdn.com/714383399/files/doc_financials/annual/FedEx_2016_Annual_Report.pdf).

<sup>39</sup> United Parcel Service, *2016 UPS Annual Report*, available at: [http://nasdaqomx.mobular.net/nasdaqomx/7/3521/5025/document\\_0/UPS\\_2016\\_Annual\\_Report-processed.pdf](http://nasdaqomx.mobular.net/nasdaqomx/7/3521/5025/document_0/UPS_2016_Annual_Report-processed.pdf)

<sup>40</sup> National Retailer Federation, *Top 100 Retailers Chart 2015*, available at: <https://nrf.com/2015/top100-table>.

<sup>41</sup> Automotive Fleet, *Top 300 Commercial Fleets*, available at: <http://digital.automotive-fleet.com/FL5002017#?page.Set=8&contentItem=0>.

<sup>42</sup> United States Postal Service, *United States Postal Service FY2017 Annual Report to Congress*, available at: <https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

<sup>43</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

## United States Postal Service: A Sustainable Path Forward

analysis of 10-K filings, in 2017, total per-employee cost at the USPS was \$85,800, compared to \$76,200 and \$53,900 at UPS and FedEx, respectively.<sup>44,45,46</sup>

### USPS's Impact on Local Economies

On a local level, studies conclude that post offices have an important role in local economic development. Table 1 presents the number of active USPS employees across the fifty states and District of Columbia, as of September 2018.<sup>47</sup> In the third quarter of 2018, the USPS employed around 630,000 employees. The states with the highest USPS employment are California, New York, and Texas.

Table 1: Number of Active USPS Employees as of September 28, 2018

| State       | Number of Active Employees | State          | Number of Active Employees |
|-------------|----------------------------|----------------|----------------------------|
| Alaska      | 1,478                      | North Carolina | 19,949                     |
| Alabama     | 9,032                      | North Dakota   | 1,838                      |
| Arkansas    | 5,495                      | Nebraska       | 4,644                      |
| Arizona     | 9,790                      | New Hampshire  | 3,348                      |
| California  | 64,560                     | New Jersey     | 21,444                     |
| Colorado    | 10,697                     | New Mexico     | 3,088                      |
| Connecticut | 8,526                      | Nevada         | 4,509                      |
| Delaware    | 2,102                      | New York       | 44,662                     |
| Florida     | 35,931                     | Ohio           | 23,905                     |
| Georgia     | 18,064                     | Oklahoma       | 6,988                      |
| Hawaii      | 2,367                      | Oregon         | 6,983                      |
| Iowa        | 7,659                      | Pennsylvania   | 28,869                     |
| Idaho       | 2,622                      | Rhode Island   | 2,583                      |
| Illinois    | 29,383                     | South Carolina | 8,463                      |
| Indiana     | 12,321                     | South Dakota   | 2,019                      |
| Kansas      | 6,554                      | Tennessee      | 12,689                     |
| Kentucky    | 7,877                      | Texas          | 43,281                     |
| Louisiana   | 8,368                      | Utah           | 5,477                      |
| Maine       | 3,356                      | Virginia       | 16,633                     |

<sup>44</sup> United States Postal Service, *Form 10-K 2017*. Retrieved from <http://about.usps.com/who-we-are/financials/>.

<sup>45</sup> Federal Express, *Form 10-K 2017*, available at: <http://investors.fedex.com/financial-information/sec-filings/default.aspx>.

<sup>46</sup> United Parcel Service, *Form 10-K 2017*, available at: [http://www.investors.ups.com/financials/sec-filings?field\\_nir\\_sec\\_form\\_group\\_target\\_id%5B%5D=471&field\\_nir\\_sec\\_date\\_filed\\_value=&items\\_per\\_page=50#view-exposed-form-widget-sec-filings-table](http://www.investors.ups.com/financials/sec-filings?field_nir_sec_form_group_target_id%5B%5D=471&field_nir_sec_date_filed_value=&items_per_page=50#view-exposed-form-widget-sec-filings-table).

<sup>47</sup> Postal Regulatory Commission, *Postal Service Active Employee Statistical Summary* (September 28, 2018), available at: <https://www.prc.gov/docs/106/106755/HAT271P1-Sept%20282018%20OCR.pdf>.

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| State         | Number of<br>Active<br>Employees | State                | Number of<br>Active<br>Employees |
|---------------|----------------------------------|----------------------|----------------------------------|
| Maryland      | 13,233                           | Vermont              | 1,634                            |
| Massachusetts | 16,216                           | Washington           | 12,100                           |
| Michigan      | 21,565                           | Wisconsin            | 11,600                           |
| Minnesota     | 12,403                           | West Virginia        | 3,702                            |
| Missouri      | 15,183                           | Wyoming              | 1,040                            |
| Mississippi   | 4,935                            | District of Columbia | 5,507                            |
| Montana       | 2,082                            | <b>TOTAL</b>         | <b>628,754</b>                   |

*Source: Postal Service Active Employee Statistical Summary - September 28, 2018*

An exhaustive study of the USPS’s indirect effects on the economy would require an analysis that is beyond the scope of this report. However, qualitative and quantitative evidence indicate that the USPS’s economic impact is substantial in both its direct activities and in the broader economic activity that it enables.

### USPS’s Role in Rural Communities

As of September 30, 2017, the USPS operated about 31,000 post offices, stations, and branches nationwide. In addition, the USPS provides services through 4,000 contract postal units, including 476 community post offices, and 821 village post offices as well as a network of commercial outlets.<sup>48</sup> Village post offices and community post offices have the expressed purpose of making postal services more accessible to rural communities. Community post offices are contract units that provide postal services to small communities.<sup>49</sup> Village post offices are located within existing communities in more rural areas in different locations such as convenience stores, libraries, and local businesses, and are operated by the management of those locations.<sup>50</sup>

Despite the closing of many post offices in the last decade that have disproportionately affected rural areas, the USPS continues to play a vital role in connecting urban and rural communities in the United States.<sup>51</sup> In 2017, the USPS delivered mail across 229,000 routes, of which around 75,000 (33 percent) were rural routes. Among its 157 million total delivery

<sup>48</sup> United States Postal Service, *United States Postal Service FY2017 Annual Report to Congress*, available at: <https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

<sup>49</sup> United States Postal Service, *Publication 100: An American History 1775-2006*, (November 2012), available at: [https://about.usps.com/publications/pub100/pub100\\_024.htm](https://about.usps.com/publications/pub100/pub100_024.htm).

<sup>50</sup> United States Postal Service, *Open a Village Post Office*, (December 2012), available at: <http://about.usps.com/news/electronic-press-kits/expandedaccess/assets/pdf/Fact-sheet-12-12-12.pdf>.

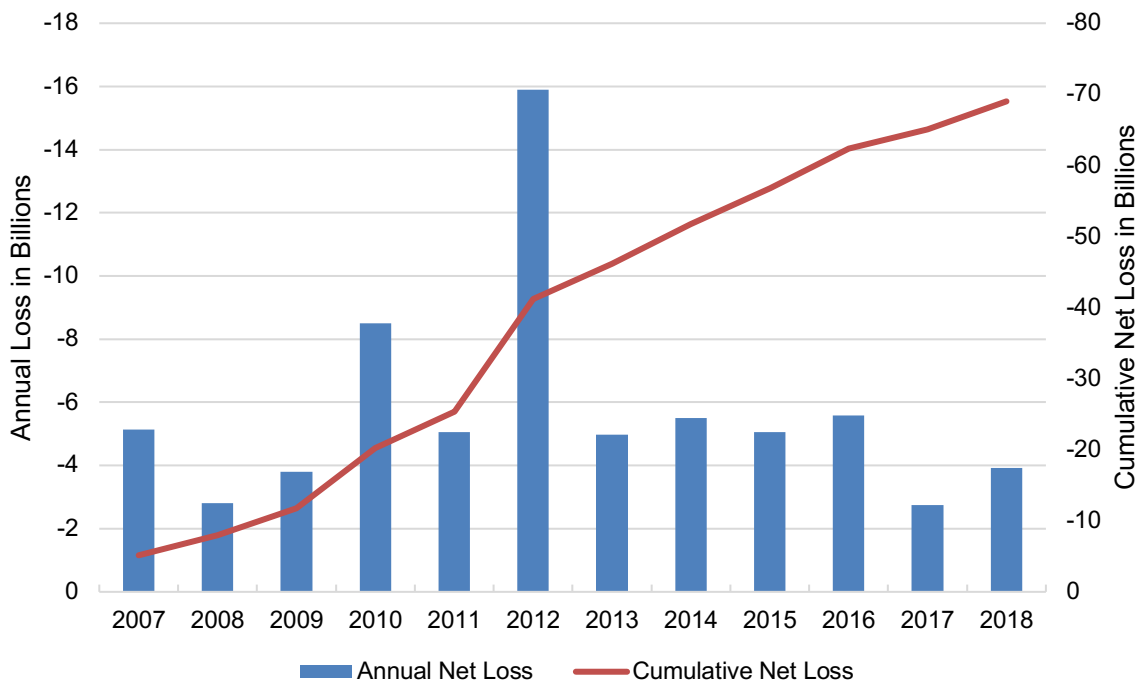
<sup>51</sup> Hutkins, Steve, “Post Office discontinuances and suspensions: A decade in review,” (February 26, 2018), available at: <https://savethepostoffice.com/post-office-discontinuances-and-suspensions-a-decade-in-review/>.

points in 2017, 43 million (27 percent) residential delivery points were services on rural carrier routes in addition to 1.6 million (1 percent) rural route business delivery points.<sup>52</sup>

### C. Current State of the USPS

The USPS’s financial condition continues to deteriorate, and it is forecast to lose tens of billions of dollars over the next decade. The USPS’s current business model – including its governance, product pricing, cost allocation, and labor practices – was sustainable in an era where mail volumes and revenues grew alongside population and economic growth. However, the shift toward digital correspondence and the corresponding effect of declining mail volumes has led to significant net losses. In FY 2018, the USPS reported a net loss of \$3.9 billion, its 12<sup>th</sup> consecutive year of net losses (see Figure 2).<sup>53</sup>

Figure 2. USPS Net Losses (\$ Billions)



Source: USPS 10-K Filings, 2007-2018

<sup>52</sup> United States Postal Service, *United States Postal Service FY2017 Annual Report to Congress*, available at: <https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

<sup>53</sup> United States Postal Service, *Form 10-K Reports 2007-2018*, available at: <http://about.usps.com/who-we-are/financials/>.



## United States Postal Service: A Sustainable Path Forward

In 2009, the GAO added the USPS to its list of high-risk entities.<sup>54</sup> Without appropriate structural reform, the USPS's growing financial burden and its unsustainable business model pose an existential threat to its operations.

### Governance and Oversight

The USPS management is led by the Board of Governors. It consists of 11 members: nine Governors with staggered terms of seven years, appointed by the President with the advice and consent of the Senate; the Postmaster General, who is appointed by the Governors; and the Deputy Postmaster General, who is appointed by the Governors and the Postmaster General.<sup>55</sup>

#### *Board of Governors*

The Board “direct[s] and control[s] the expenditures and review[s] the practices and policies of the Postal Service.”<sup>56</sup> While most matters are under the control of the full 11-member Board, certain functions, including raising rates and appointing an Inspector General, are reserved for decision by the nine Governors. Between December 2016 and August 2018, the USPS Board had no Governors. Although several nominees for Governor have been put forward in this and the previous Administration, only two Governors have been confirmed by the Senate since 2010.

#### *Office of Inspector General*

The USPS Office of Inspector General (OIG) is an independent law enforcement and oversight agency for the USPS.<sup>57</sup> The responsibilities of the USPS OIG include conducting audits and investigations; promoting economy, efficiency, and effectiveness in the conduct of postal programs and operations; preventing and detecting fraud and abuse; and keeping the Governors and Congress informed about problems, deficiencies, and corrective actions.<sup>58</sup> The Inspector General is appointed to a seven-year term. Since the retirement of the previous Inspector General in 2015, the position has been held by an Acting Inspector General.

#### *Postal Regulatory Commission*

The Postal Regulatory Commission (PRC) is an independent establishment of the executive branch.<sup>59</sup> It is composed of five Commissioners who are appointed by the President with the advice and consent of the Senate.<sup>60</sup> The Commission:

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<sup>54</sup> United States Government Accountability Office, *U.S. Postal Service: Key Considerations for Restoring Fiscal Sustainability*, GAO-17-404T, (February 7, 2017), available at <https://www.gao.gov/assets/690/682534.pdf>.

<sup>55</sup> 39 U.S.C. § 202.

<sup>56</sup> 39 U.S.C. § 205.

<sup>57</sup> 39 CFR § 221.3.

<sup>58</sup> *Ibid.*

<sup>59</sup> 39 U.S.C. § 501.

<sup>60</sup> 39 U.S.C. § 502.

## United States Postal Service: A Sustainable Path Forward

- Develops and maintains regulations for a modern system of rate regulation, including the proper allocation of costs to products and services;
- Consults with the USPS on delivery service standards and performance measures;
- Consults with the Department of State on international postal policies;
- Adjudicates rate and service complaints;
- Offers advisory opinions on proposed nationwide changes in postal services;
- Provides an annual report to the President and Congress;
- Issues an annual compliance determination to assess whether the USPS's rates, fees, and services comport with the requirements of applicable law; and
- Acts on postal patrons' appeals concerning USPS decisions to close or consolidate post offices.<sup>61</sup>

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<sup>61</sup> 39 C.F.R. § 3002.2(a).

## United States Postal Service: A Sustainable Path Forward

Table 2: USPS Revenue, Expenditures, and Volume Trends

| <b>USPS Domestic Mail and Package Revenue and Volume Trends</b> <i>(in Billions)</i> |       |       |       |       |       |       |       |       |       |
|--|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|  | 2010  | 2011  | 2012  | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
| <b>Mail Revenue</b> (\$)   | 50.6  | 49.0  | 47.0  | 46.7  | 47.4  | 47.5  | 46.6  | 43.6  | 42.7  |
| <b>Mail Volume</b> (pieces)  | 166.9 | 164.1 | 155.4 | 153.7 | 150.5 | 148.7 | 148.2 | 142.7 | 139.9 |
| <b>Package Revenue</b> (\$)  | 10.3  | 10.7  | 11.6  | 12.6  | 13.8  | 15.1  | 17.5  | 19.5  | 21.5  |
| <b>Package Volume</b> (pieces)   | 3.1   | 3.3   | 3.5   | 3.7   | 4.0   | 4.5   | 5.2   | 5.7   | 6.2   |

| <b>USPS Revenue and Expenditures</b> <i>(Dollars in Billions)</i> |       |       |        |       |       |       |       |       |       |
|---|-------|-------|--------|-------|-------|-------|-------|-------|-------|
|   | 2010  | 2011  | 2012   | 2013  | 2014  | 2015  | 2016  | 2017  | 2018  |
| <b>Total Revenue</b>  | 67.1  | 65.7  | 65.2   | 67.3  | 67.9  | 69.0  | 71.5  | 69.7  | 70.7  |
| <b>Expenses Excluding RHB</b>                                     | 70.1  | 70.8  | 70.1   | 66.7  | 67.7  | 68.3  | 71.3  | 68.2  | 70.0  |
| <b>Operating Income (prior to RHB)</b>                            | (3.0) | (5.1) | (4.8)  | 0.6   | 0.2   | 0.6   | 0.2   | 1.5   | 0.7   |
| <b>RHB (10-Year Prefunding)</b>                                   | 5.5   | 0.0*  | 11.1*  | 5.6   | 5.7   | 5.7   | 5.8   | -     | -     |
| <b>RHB (40-Year Amortized Prefunding)</b>                         | -     | -     | -      | -     | -     | -     | -     | 1.0   | 0.8   |
| <b>Annual Accrual of RHB</b>                                      | -     | -     | -      | -     | -     | -     | -     | 3.3   | 3.7   |
| <b>Net Income (Including RHB)</b>                                 | (8.5) | (5.1) | (15.9) | (5.0) | (5.5) | (5.1) | (5.6) | (2.8) | (3.9) |

*\* The USPS failed to prefund its retiree health benefit (RHB) payments after 2010. Congress shifted the USPS's 2011 prefunding payment to 2012, resulting in an \$11.1 billion liability in 2012.*

*Source: USPS 10-K Filings, 2007-2018*

### USPS Revenue

The USPS has witnessed an overall decline in mail revenue. This is due to a decrease in mail volumes driven by the rise of digital alternatives and an inability to raise prices sufficiently to make up for the revenue lost due to volume declines (see Table 2).<sup>62</sup> Moreover, package deliveries, while growing in volume, are unable to make up for most of the lost revenue from the decline in mail volumes.

#### *Mail Volume*

The overall mail market in the United States consists of not only the USPS, but also private companies that prepare and transport mail products in partnership with the USPS. The USPS contributes to this market through the receipt, transport, processing, and delivery of First-Class Mail, Marketing Mail (formerly called Standard Mail), Periodical Mail, Media Mail, Library Mail (i.e., books), and Bound Printed Matter (e.g., large catalogs).

Historically, the USPS's mail monopolies have provided the USPS with pricing power and protected access to the mailbox that, in an environment characterized by rising mail volumes, afforded the USPS a sustainable business model. However, with the rapid expansion of alternative communication technologies and the shift toward electronic transactions, the USPS's monopoly powers have diminished and its mail volumes have declined.

In 2018, the USPS delivered around 140 billion pieces of mail and 6 billion packages to 159 million delivery points. Although the number of delivery points increased 7.4 percent between 2007 and 2018, total mail volumes declined 33 percent (see Figure 3). Households received 18 pieces of mail per week in FY 2017, compared to 25 in FY 2008.<sup>63,64</sup>

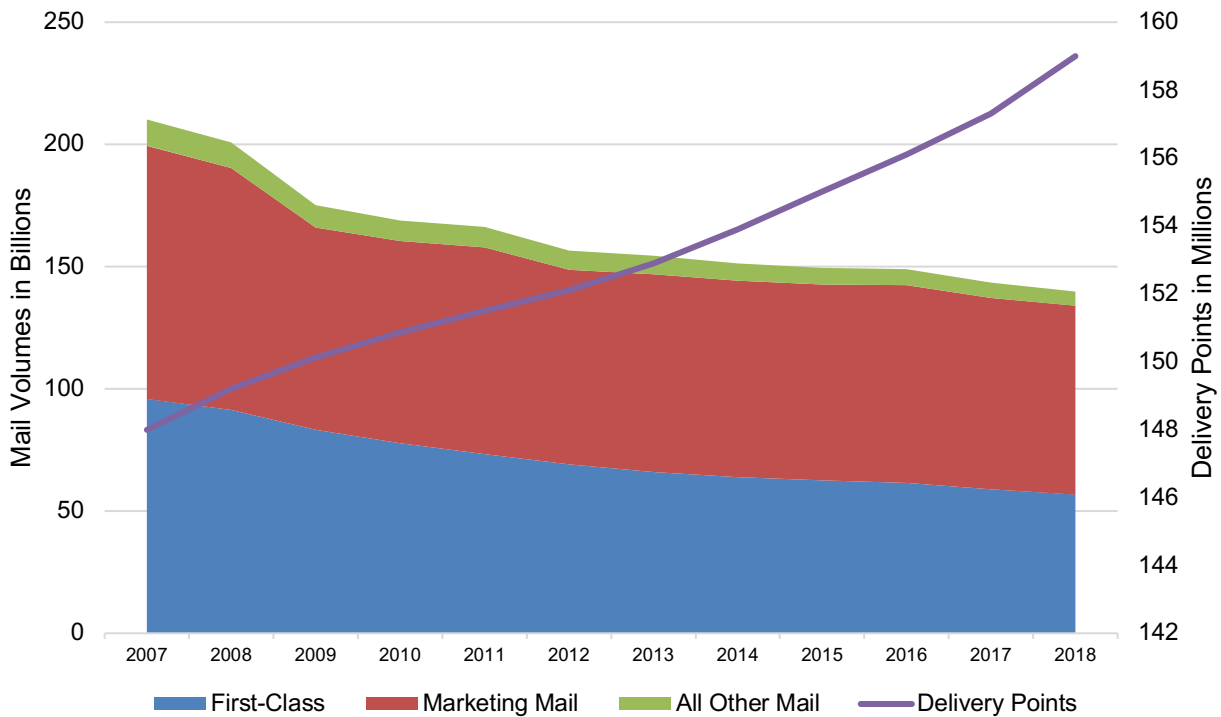
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<sup>62</sup> The implementation of the Market Dominant Mail Exigent Surcharge beginning in FY 2014 and ending mid-way through FY 2016 added approximately \$4.6 billion in additional revenue over that time period. These additional revenues slightly offset the lost revenue from volume losses for FY 2014 and FY 2015.

<sup>63</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2017*, (March 2018), available at: [https://www.prc.gov/docs/105/105134/USPS\\_HDS\\_FY17\\_Final%20Annual%20Report.pdf](https://www.prc.gov/docs/105/105134/USPS_HDS_FY17_Final%20Annual%20Report.pdf).

<sup>64</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2008*, (March 2009), available at: <http://about.usps.com/studying-americans-mail-use/household-diary/usps-bds-fy08.pdf>.

Figure 3. USPS Mail Volume and Delivery Points



Source: USPS Revenue, Pieces and Weight Reports from 2007-2017

Mail volume and revenue have been in decline since 2007 primarily due to: 1) the shift of communication and bill payments to electronic alternatives as a result of technological changes; 2) the transition of commercial communications and advertising to online services; and 3) the decline in print publications and magazines.<sup>65,66,67</sup> The 2007–2009 financial crisis and recession contributed significantly to volume declines of both First-Class and Marketing Mail.<sup>68</sup> With continued and increased reliance on internet-based communications since that time, the prevailing trend of declining First-Class Mail is likely to be permanent.

<sup>65</sup> United States Postal Service, Office of Inspector General, *A New Reality: Correspondence Mail in the Digital Age*, RARC-WP-18-004, (March 5, 2018), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2018/RARC-WP-18-004.pdf>.

<sup>66</sup> United States Postal Service, Office of Inspector General, *Transactional Mail: Implications for the Postal Service*, RARC-WP-18-007, (April 16, 2018), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2018/RARC-WP-18-007.pdf>.

<sup>67</sup> United States Government Accountability Office, *U.S. Postal Service: Strategies and Options to Facilitate Progress toward Financial Viability*, GAO-10-455, (April 12, 2010), available at: <https://www.gao.gov/products/GAO-10-455>.

<sup>68</sup> Ibid.

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When categorized based on its primary purpose, Marketing Mail has increased modestly as a percentage of total mail from 61 percent to 62 percent over the past 10 years, while Transaction Mail as a percentage of total mail fell from 25 percent to 19 percent over the same period.<sup>69,70</sup> Periodicals have been in long-term decline, peaking in 1990 at 10.7 billion pieces – as compared to 5.3 billion in 2017.<sup>71,72</sup>

### *Package Volume*

While the package market is a large and growing segment of the transportation and logistics sector, the USPS's revenue growth from less profitable packages has been insufficient to fully replace revenue lost due to the decline in mail. Revenue from packages grew from \$7.9 billion in FY 2007 to \$21.5 billion in FY 2018.<sup>73</sup> The total annual volume of domestic package deliveries grew from 1.6 billion to 6.2 billion over that same time-period (see Figure 4). In 2018, package products accounted for 30 percent of total USPS revenue, up from 11 percent in 2007.<sup>74</sup>

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<sup>69</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2008*, (March 2009), available at: <http://about.usps.com/studying-americans-mail-use/household-diary/usps-bds-fj08.pdf>.

<sup>70</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2017* (March 2018), available at [https://www.prc.gov/docs/105/105134/USPS\\_HDS\\_FY17\\_Final%20Annual%20Report.pdf](https://www.prc.gov/docs/105/105134/USPS_HDS_FY17_Final%20Annual%20Report.pdf).

<sup>71</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2010*, (April 2011), available at: <https://about.usps.com/studying-americans-mail-use/household-diary/2010/fullreport-pdf/usps-bds-fj10.pdf>.

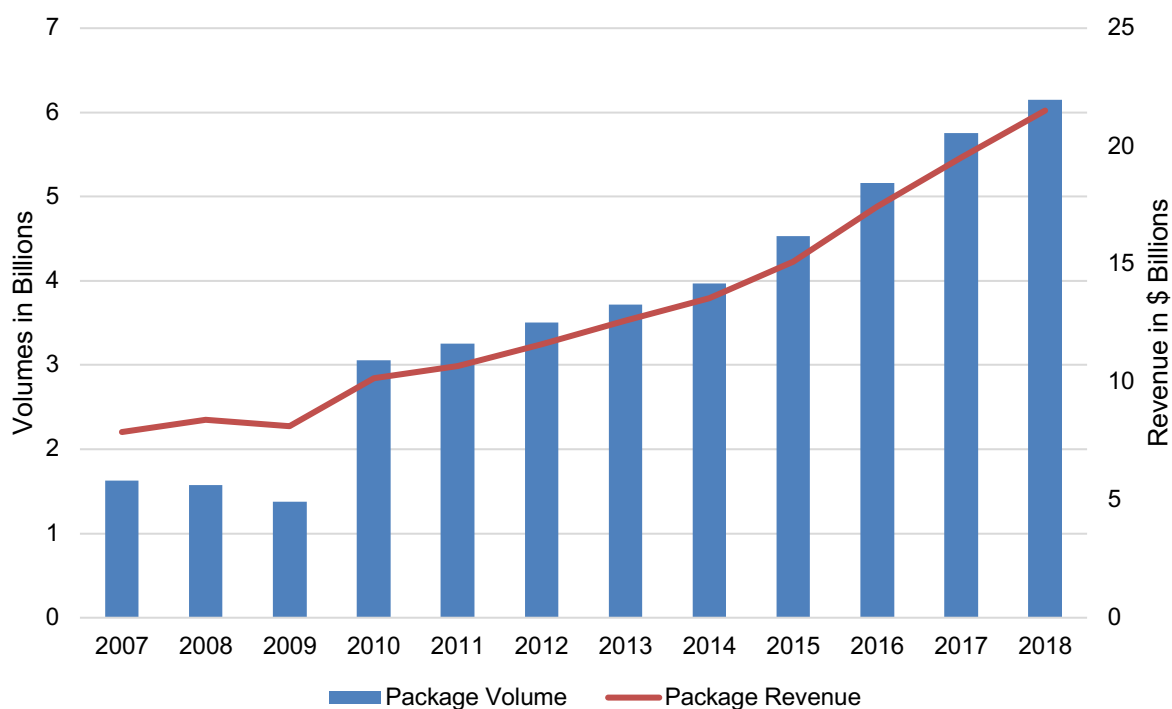
<sup>72</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fj2017.pdf>.

<sup>73</sup> United States Postal Service, *Form 10-K Reports 2007-2018*, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>74</sup> Ibid.



Figure 4: Package Volume and Revenue (Billions)



Source: USPS 10-K Filings, 2007-2018

The USPS’s package services include: Priority Mail, Priority Mail Express, Retail Ground, Parcel Select, Parcel Return, and First-Class Package Service (retail and commercial). Parcel Select, the USPS’s “last mile” package delivery service, constitutes the largest segment (55 percent) of the USPS’s package business, with 2.8 billion pieces delivered in FY 2017.<sup>75</sup> Parcel Select volumes have grown in parallel with e-commerce, registering a compound annual growth rate of 34 percent since FY 2010.<sup>76</sup> The USPS’s other major package services include Priority Mail, a 1-3 business day delivery services, and First-Class Package Service, consisting of commercial parcels under one pound and retail parcels under 13 ounces. In FY 2017, USPS delivered 1.1 billion Priority Mail and 1.2 billion First-Class Package Service packages – less than 10 percent of total U.S. domestic package volume.<sup>77</sup>

### Growing Expenses

The USPS’s financial condition is the result of a combination of declining mail revenues and rising expenses (see Table 2 above). While the USPS has taken measures to control costs,

<sup>75</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2017.pdf>.

<sup>76</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) Reports 2010-2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2010.pdf>.

<sup>77</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2017.pdf>.

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including reducing employment and workhours, reducing post office operating hours, consolidating mail facilities, and improving resource utilization, these measures have been insufficient to counter revenue losses from declining mail volumes and other rising costs. The USPS's expenses are expected to continue to grow, as new delivery points are added and as package delivery expands.

### *Labor Costs*

Employee compensation and benefits accounts for around 76 percent of the USPS's total expenses.<sup>78</sup> These costs represent a much higher share of the USPS's overall costs when compared against other private courier companies.<sup>79,80</sup> Between 2014 and 2017, the USPS's total workforce increased by 26,247 employees (14,803 career and 11,444 non-career) – in sharp contrast to the decrease of over 53,973 employees between 2010 and 2013.<sup>81</sup> The increase was due in large part to the increase in work hours associated with the increases in package deliveries. This resulted in an increase of \$3.1 billion in personnel costs (not counting required Postal Service Retiree Health Benefits Fund contributions). Contractual wage and Cost of Living Allowance (COLA) raises also contributed to the increase. In addition to and independent of COLA, postal workers receive a 1 to 1.5 percent increase in wages each year, increasing hourly wages at a faster rate than other federal government employees and at a faster rate than the pricing rate caps on many of their products. Given the expected growth in package delivery services, personnel costs are expected to continue to increase in future years, offsetting the increase in the corresponding revenue.

### *Infrastructure Expenses*

The USPS projects that it will need to increase average annual capital spending to \$2.4 billion for FY 2018 - FY 2028, roughly 70 percent more than the \$1.4 billion average spent during FY 2007 - FY 2017.<sup>82</sup> The increased spending is needed to make critical infrastructure investments that have been deferred in recent years due to financial shortfalls. These include the acquisition of a new fleet of delivery vehicles to replace its aging existing fleet and purchases of new mail-processing equipment to increase efficiency. As the USPS started acquiring most of its existing delivery fleet in 1987, the majority of its delivery vehicles are several decades old. Further, according to a Government Accountability Office (GAO)

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<sup>78</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>79</sup> Federal Express, *Annual Reports 2015-2017*, available at: <http://investors.fedex.com/financial-information/annual-reports/default.aspx>.

<sup>80</sup> United Parcel Service, *Annual Reports 2015-2017*, available at: <http://www.investors.ups.com/financials/annual-reports>.

<sup>81</sup> United States Postal Service, *Annual Reports 2007-2017*, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>82</sup> United States Government Accountability Office, *U.S. Postal Service: Projected Capital Spending and Processes for Addressing Uncertainties and Risks*, GAO-18-515, (June 2018), available at: <https://www.gao.gov/assets/700/692859.pdf>.

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analysis, 80 percent of the USPS's projected capital spending for FY 2018 is for projects needed to sustain its current operations, as opposed to investments that will allow for increased revenues or decreased costs.<sup>83</sup>

### *Universal Service Obligation*

A universal service obligation (USO) is generally viewed as an obligation of a mail service provider to give all users in an area access to basic services at affordable rates. Under current law, the USPS is obligated to provide an efficient system of delivery nationwide and a uniform rate in each letter class.<sup>84</sup> Current statutes also prohibit the closure of small post offices solely for operating at a deficit.<sup>85</sup> The PRC estimated the FY 2016 cost to the USPS of providing universal mail services is \$4.4 billion. This includes supplying postal services to areas of the nation the USPS would not otherwise serve, free or reduced rates for postal services as required by law, and other public services or activities the USPS would not otherwise provide, but for the requirements of the law.<sup>86,87</sup> This cost estimate amounts to over 5.5 percent of the USPS's FY 2016 expenses.<sup>88</sup> The GAO has recommended that Congress reconsider the level of services provided under the USO, based on updated customer needs, as a potential way to reduce the USPS's operating costs.

### *Unfunded Liabilities and Debt*

The USPS's unfunded liabilities, including retiree health benefits, workers' compensation claims, pension benefits, and debt to the Federal Financing Bank, restrict its ability to make necessary productive investments. At the end of FY 2018, the USPS's total unfunded liabilities and debt were \$139.6 billion. Table 3 shows the composition of these liabilities.

The USPS did not make required payments in FY 2018 for normal retiree health benefits obligations (\$3.7 billion) or amortized costs for retiree health benefit unfunded liabilities (\$815 million).<sup>89</sup> The USPS did not make required amortized payments for Federal Employee Retirement System (FERS) unfunded liabilities (\$958 million) or Civil Service Retirement System (CSRS) unfunded liabilities (\$1.4 billion).<sup>90</sup> The USPS delayed making these payments to preserve liquidity. Further, with \$13.2 billion in debt owed to the Federal Financing Bank, the USPS has used most of its statutory borrowing limit of \$15 billion.<sup>91</sup>

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<sup>83</sup> Ibid.

<sup>84</sup> 39 U.S.C. §§ 403(b) and 404(c).

<sup>85</sup> 39 U.S.C. § 101(b).

<sup>86</sup> See, e.g., 39 U.S.C. §§ 3403 and 3406.

<sup>87</sup> Postal Regulatory Commission, *Annual Report to the President and Congress, Fiscal Year 2017* (Jan. 26, 2018), available at:

<https://www.prc.gov/sites/default/files/reports/PRC%20FY%202017%20Annual%20Report%20Filed.pdf>.

<sup>88</sup> United States Postal Service, *United States Postal Service FY2017 Annual Report to Congress* (2017), available at:

<https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

<sup>89</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at:

<http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>90</sup> Ibid.

<sup>91</sup> Ibid.

Table 3: Postal Service Long-Term Liabilities, FY 2018 (\$ Billions)

| Long-Term Liability                        | Amount         |
|--|----------------|
| <b>Unfunded Pension Liabilities</b>        |                |
| Civil Service Retirement System (CSRS)     | \$25.1         |
| Federal Employees Retirement System (FERS) | \$18.4         |
| <b>Total Unfunded Pension Liabilities</b>  | <b>\$43.5</b>  |
| <b>Other Long-Term Liabilities</b>         |                |
| Retiree Health Benefits (RHB)              | \$66.5         |
| Workers' Compensation                      | \$16.4         |
| Debt to Federal Financing Bank             | \$13.2         |
| <b>Total Long-Term Liabilities</b>         | <b>\$139.6</b> |

Source: USPS 10-K Filing 2018

### *Prefunding of Retiree Health Benefits*

Under PAEA, the USPS was required to prefund retiree health benefits through contributions to a Postal Service Retiree Health Benefits Fund (PSRHBF). Prefunding was required through payments over a 10-year period from 2007 to 2016, with cumulative contributions of \$51.8 billion (originally, the required amount was \$55.8 billion, but this was later reduced to \$51.8 billion when the 2009 payment was reduced from \$5.4 billion to \$1.4 billion after the financial crisis).<sup>92</sup> Additionally, the USPS was required to contribute \$3.0 billion representing the required escrow amount from the legislation passed in 2003 and any estimated surplus determined by OPM from the Civil Service Retirement Fund attributed to USPS (this amounted to \$17 billion as of the end of FY 2006). These payments were required in addition to the USPS's required payments for current year costs, which cover the annual share of retiree health premiums.

Through FY 2010, the USPS contributed \$20.9 billion to the PSRHBF; however, beginning in 2011, the USPS did not make the required payments for FY 2011 through FY 2016 of \$33.9 billion.<sup>93</sup> Although the 10-year period for prefunding ended in FY 2016, the USPS is still required to make amortized payments to cover its unfunded retiree health benefit liabilities and to pay "normal costs" associated with retiree health benefits for active employees. However, the USPS did not make its required amortization payments of \$955

<sup>92</sup> United States Postal Service, *Form 10-K Reports 2007-2017*, available at: <http://about.usps.com/who-we-are/financials/>

<sup>93</sup> Ibid.

million and \$815 million, and its normal costs payments of \$3.3 billion and \$3.7 billion for FY 2017 and FY 2018 respectively.<sup>94</sup>

### Statutory and Regulatory Restrictions

The letter delivery and mail monopolies give the USPS exclusive rights to most letter deliveries and provide it with an advantage in the delivery of smaller packages. As a government entity, the USPS is exempt from state and local taxes (including property taxes), parking tickets, and a range of other local ordinances, including state and local zoning laws and building code requirements.<sup>95</sup>

However, as a government entity, the USPS faces statutory and regulatory restrictions that do not apply to private companies. The USPS's ability to raise prices on classes of market-dominant mail is generally capped by the rate of change in the consumer price index for all urban consumers (CPI-U).<sup>96</sup> Other pricing regulations (such as workshare discount provisions) further limit pricing flexibility.<sup>97</sup> When the USPS seeks to change service standards in its retail or processing networks, it is required to consult with the PRC.<sup>98</sup> This process can slow or limit the USPS's flexibility to make service standard changes. An annual appropriations provision, which provided approximately \$35 million in revenue in 2017 (or less than one-sixth of one percent of 2017 revenue), bars the USPS from changing the frequency of mail delivery.<sup>99</sup> Statutory restrictions that limit the top salary of the USPS's critical senior management also restrict its ability to attract and keep leadership.<sup>100</sup>

### Pricing Limitations

The USPS's pricing for both mail and package products is subject to review and approval by the PRC. This reduced latitude to raise prices on mail products has provided price consistency and certainty for mail senders. However, it has limited the ability of the USPS to adjust its prices to meet its financial needs. Because of price controls on market-dominant products and low inflation rates during the recession, revenue could not be recaptured during the recession through price increases. Instead, adjustments could only be made

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<sup>94</sup> Ibid.

<sup>95</sup> Federal Trade Commission, *Accounting for Laws that Apply Differently to the United States Postal Service and its Private Competitors* (December 2007), available at: <https://www.ftc.gov/sites/default/files/documents/reports/accounting-laws-apply-differently-united-states-postal-service-and-its-private-competitors-report/080116postal.pdf>.

<sup>96</sup> 39 U.S.C. § 3622(d)(2)(A) restricts the CPI-U rate cap to a class of mail; however, different products within the class, such as Single-Piece First-Class, could receive a larger than CPI increase in rate, though other products such as presorted products could receive increases less than CPI to compensate.

<sup>97</sup> 39 U.S.C. § 3622(e).

<sup>98</sup> 39 U.S.C. § 3691.

<sup>99</sup> U.S. Government Publishing Office, *Consolidated Appropriations Act, 2017*, Pub. L. No. 115-31, 131 Stat. 135, 369 (May 5, 2017), available at: <https://www.congress.gov/115/plaws/publ31/PLAW-115publ31.pdf>.

<sup>100</sup> 39 U.S.C. § 3686(c).

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through cost reductions or specific requests for PRC approval for “exigent,” or above CPI-U price cap, rate increases, which proved difficult, inadequate, and time consuming. While prices for package products are required to cover product costs and a portion of shared infrastructure costs, there is no explicit ceiling for package price increases.

To cover losses incurred during the recession, the USPS first requested a permanent “exigent” increase in mail rates from the PRC in 2010. In December 2013, the PRC approved a temporary “exigent surcharge” for mail products to generate \$3.2 billion in incremental revenue. In July 2015, the PRC authorized the surcharge to continue until USPS collected a total of \$4.6 billion in incremental revenue estimated to have been lost during the 2007-09 recession.<sup>101</sup> While the PRC permitted the surcharge, it determined that the surcharge should be temporary and must expire once the estimated revenues, needed to make up for the losses incurred during the recession, were collected. The \$4.6 billion limit was reached on April 10, 2016 and USPS reduced prices on mail rates accordingly.<sup>102</sup> During the PAEA required 10-year review of the price-cap regulations and in response to the USPS’s troubled financial condition, the PRC recently proposed a revision to its rules that if made final would allow the USPS to raise prices by up to 3 percentage points more than CPI-U, provided basic service levels are met.<sup>103</sup>

### *New Products and Services*

Market tests of new products and services also require PRC approval.<sup>104</sup> This hinders the USPS’s ability to rapidly adjust to changing technology, an evolving business environment, or to declines in existing classes of mail volume.

### *Postal Facility Closures*

Although the USPS has the authority to close retail postal facilities without seeking legislative approval, closing facilities has proven difficult and is often unpopular. Before deciding to close a facility, the USPS must evaluate a set of criteria including the effect on the community and the facility’s employees.<sup>105</sup> The USPS’s decision to close a post office can also be appealed to the PRC, which can set aside the USPS’s decision.<sup>106</sup> Moreover, the USPS is barred from closing a small post office solely for running a deficit.<sup>107</sup> In the last ten years, the USPS has announced three sets of retail facility closures and realignments – the

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<sup>101</sup> U.S. Government Accountability Office, *U.S. Postal Service: Continuing Financial Challenges and the Need for Postal Reform*, GAO-16-651T (May 11, 2016), available at: <https://www.gao.gov/products/GAO-16-651T>.

<sup>102</sup> Ibid.

<sup>103</sup> Postal Regulatory Commission, *Notice of Proposed Rulemaking for the System for Regulating Rates and Classes for Market-Dominant Products*, Docket No. RM2017-3 (Dec. 1, 2017), available at: <https://www.prc.gov/docs/102/102715/Order4258.pdf>.

<sup>104</sup> 39 U.S.C. § 3641; 39 C.F.R. § 3035.4.

<sup>105</sup> 39 U.S.C. § 404(d)(2)(A).

<sup>106</sup> 39 U.S.C. § 404(d)(5).

<sup>107</sup> 39 U.S.C. § 101(b).



first in July 2009 and the second in July 2011 – only to scale down these plans with the third realignment in May 2012.<sup>108</sup>

### D. International Postal Models

Despite decreasing mail volumes and changes in communication technology, postal services continue to play a critical role around the world. The Universal Postal Union (UPU) governs the exchange of international mail and packages between national postal operators, while each country is responsible for its national postal infrastructure and operations. This section highlights key aspects of foreign postal services. While reviewing foreign postal systems is an informative exercise, the size and complexity of the U.S. system makes it difficult to compare the experiences of foreign postal systems with those of the United States Postal System.

#### *Privatization of Postal Services*

As shown in Table 4, many industrialized countries have pursued privatization of their postal systems – either completely or in part – to lower costs for consumers while improving service quality.<sup>109</sup> For example, in 1995 the German government incorporated the German mail authority, creating the company Deutsche Post, which was majority-owned by the German government. In 2000, Germany launched an initial public offering (IPO) of Deutsche Post further privatizing the institution and raising \$5.6 billion.<sup>110</sup>

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<sup>108</sup> Postal Regulatory Commission, Docket No. N2009-1, Order No. 244 (Dec. 2, 2009), Docket No. N2011-1, Order No. 778 (Nov. 4, 2011) and Docket No. N2012-2, Order No. 1361 (Aug. 23, 2012).

<sup>109</sup> Soifer, Don, Consumer Postal Council, *Universal Postal Service in Major Economies* (June 2015), available at: <http://www.postalconsumers.org/wp-content/uploads/2018/01/June-2015-CPC-Universal-Postal-Service-Report.pdf>.

<sup>110</sup> Polis, Jared, Colorado State Board of Education, *Privatizing and Eliminating the Monopoly of the United States Postal Service* (August 2001), available at: <https://i2i.org/wp-content/uploads/2011/06/4-2001.pdf>.



Table 4: Summary of Major National Postal Systems

| Country     | USO Fund | Privatized? <sup>111</sup> | Percentage of Global Postal Service Revenue |
|-------------|----------|----------------------------|---|
| Germany     | N        | Y                          | 23.50%                                      |
| U.S.        | N        | Partial                    | 21.70%                                      |
| China       | Y        | N                          | 10.50%                                      |
| France      | Y        | Y                          | 9.10%                                       |
| Japan       | N        | Y                          | 7.50%                                       |
| UK          | N        | Y                          | 4.90%                                       |
| Italy       | Y        | Y                          | 4.10%                                       |
| Switzerland | Y        | Partial                    | 3.00%                                       |
| Brazil      | Y        | N                          | 2.30%                                       |
| Canada      | N        | N                          | 1.90%                                       |

Source: *Universal Postal Service in Major Economies* (June 2015)

### Universal Service Obligation

As noted earlier, a USO is an obligation of a mail service provider to give all users in an area access to basic services at affordable rates. Even under privatized postal systems, governments and regulators have typically maintained a USO to ensure that all customers have access to certain products and services. Maintaining a USO under a competitive market requires a policy determination of who should carry the USO burden, how to fund it, and who will pay for its cost.<sup>112</sup>

For example, in New Zealand, which has a fully privatized postal system, the operator has a “Deed of Understanding” with the government, ensuring the provision of the USO. The designated operator does not receive public subsidies and cannot cross-subsidize commercial ventures with mail revenues.<sup>113</sup> Sweden uses a similar structure where the designated operator is responsible for funding the USO without additional public funding.

Other means for funding the USO include compensation funds, contributions from consumers, and revenues from monopoly services. For example, France has a USO compensation fund, which becomes active if the postal regulatory authority determines that the national mail carrier bears an unfair burden to provide universal services. All licensed

<sup>111</sup> Privatized in this context refers to postal markets that are open to outside competition. ‘Partial’ indicates that third parties may perform portions of the “value chain” or that certain products are excluded from competition.

<sup>112</sup> Chone, Philippe, Laurent Flochel, and Anne Perrot, *International Journal of Industrial Organization*, v. 20, issue 9, “Allocating and funding universal service obligations in a competitive market,” p. 1247-1276, (November 2002), available at: <https://www.sciencedirect.com/science/article/pii/S0167718701000777>.

<sup>113</sup> Soifer, Don, Consumer Postal Council, *Universal Postal Service in Major Economies* (June 2015), available at: <http://www.postalconsumers.org/wp-content/uploads/2018/01/June-2015-CPC-Universal-Postal-Service-Report.pdf>.

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postal operators contribute to the fund based on the volume of the postal items within the universal service area. In some instances, compensation funds are short-term solutions, designed to help to support the cost of delivering to high-cost routes by the designated carrier.<sup>114</sup> However, they have proven costly to administer and implement.

The USPS has limited funding options for the USO. Since the USPS has a monopoly over market dominant mail, funding mechanisms that rely on contributions from postal operators or service providers to offset costs are not relevant for products covered under the USO. In addition, USPS is limited in its ability to share costs with customers due to the price caps on monopoly products.

State funding of the USO is widely used among EU member countries. In Sweden, subsidies fund USO services in rural areas for aged and blind persons. The UK government also provides subsidies to rural post offices. The USPS receives a small subsidy from the federal government to provide services to the legally blind and for paper-based overseas ballots.<sup>115</sup> However, the ability to determine and receive additional subsidies is largely legislative and complicated to administer.

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<sup>114</sup> Ibid.

<sup>115</sup> United States Postal Service, Office of Inspector General, *Funding the Universal Service Obligation*, RARC-WP-16-005 (Mar. 21, 2016), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-005.pdf>.

## Mission and Business Model

The USPS's current business model has become outdated due to changes in technology, markets, and customer needs and preferences. It is unsustainable and must be fundamentally changed if the USPS is to avoid a financial collapse and a taxpayer-funded bailout. Under the current model, the USPS cannot survive on an operating basis, let alone pay for its long-term liabilities including its debt and unfunded retiree benefits. Providing the USPS with financial relief, such as relieving it of certain post-employment liabilities, will be insufficient to correct the USPS's problems. Reforming its business model, rather than simply providing relief, is necessary if the USPS is to survive in the digital economy.

The USPS's business model has many components, starting with an implicit public policy goal and a value proposition for customers. It includes how the USPS defines its products and services, targets and markets to its customers, incurs expenses and structures costs, prices its offerings, and interacts with commercial firms and competing products. Ultimately, the business model defines the formula needed to generate sufficient revenue while fulfilling its mission as a government entity.

The Task Force believes that all components of the USPS's business model must be reevaluated and redefined in order to produce a new and viable business model. Updating some components but not others, or updating different components in isolation of others, will not result in a coherent, sustainable strategy. This chapter discusses the major components of the existing business model, the changes in technology and markets that have disrupted the model, and the types of reforms that must occur to establish a new model. These recommended reforms are expanded in the chapters that follow, detailing findings and recommendations for the USO, mail and package businesses, and the USPS's operations.

### A. Historical Business Model

For the purpose of this report, the name of the current USPS business model is the "statutory monopoly." It has existed in various iterations since the founding of the country and is based on the effectiveness of the mail monopoly as the USPS's primary means of generating revenue. It assumes that legal barriers will prevent other firms from competing with the USPS to divert revenue, and that other products cannot be substituted for postal mail to weaken the USPS source of revenue. The 1970 PRA, which converted the Post Office Department into the USPS as a self-sustaining entity, was based on this business model. The 2006 PAEA assumed that the business model developed under the PRA would continue to be viable for the foreseeable future. Indeed, the cornerstone of PAEA is that

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the mail monopoly was so effective that postage rate increases could be capped and still generate the operating margins necessary to prefund retiree health benefits.

In the last decade, technological changes have significantly reduced the effectiveness of the statutory monopoly business model by undermining the historical barriers to market competition and product substitution. Citizens and businesses increasingly view digital communications provided by private companies as a superior substitute for many uses of postal mail. In addition, due to the rise in e-commerce, the USPS's package business increasingly competes with a robust and growing network of national, regional, and local delivery companies. To respond to these changes and return the USPS to financial stability, the USPS must adopt a new, more targeted business model that is based on providing essential mail and package services for which there is no cost effective, nationwide, private sector substitute. This proposed new business model should be based on the USPS's role as a provider of "essential services."

### Policy Goal

The longstanding public policy goal in the statutory monopoly business model is to provide postal services as if they were a "public good." Public goods are goods or services that are provided without profit to benefit all members of society. A public good is a good or service that one individual can consume without reducing its availability to another individual and from which no one is excluded from consuming. Lighthouses are an often-used example of a public good. Public goods can be provided by a private entity, but are frequently provided by the government in order to promote social welfare.

Although postal services have the characteristics of private goods (e.g., a person cannot send a letter without paying for it), they have historically been regarded as a public good to be provided by the government. Creating a single postal network as a government utility both reduced costs through national economies of scale and ensured that all citizens and business had access to communication services. This policy mandate of treating postal services as if they are a public good has been a central component of the USPS's business model.

The ability to treat postal services as a public good, however, has changed rapidly due to technology. Privately provided communications through email, text messaging, social media, websites, and mobile apps are not only less expensive than postal services, but also more closely approximate many public good characteristics. Anyone can consume these services largely without paying for them and without reducing the ability of others to do so. These privately provided public goods are quickly driving out the USPS's quasi-public good.

## B. Creation of a New Business Model

The Task Force believes that the reformed USPS business model must embody a new public policy goal, recognizing that private products and competitive markets increasingly meet the

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country's communications and commerce needs. The new policy goal should have the more targeted function of correcting the failures and inefficiencies of these private markets. Future postal strategies for products, pricing, competing, and operating should be centered on meeting the needs of mail and package customers who are not reasonably served by commercially available products.

### Value Proposition

The primary value proposition of the current business model is the provision of least-cost communication services to the nation. The USPS and its predecessors successfully delivered this value for decades through the most efficient mail infrastructure in the world. As discussed above, however, this value proposition is increasingly less relevant to citizens and businesses due to the emergence of virtually free digital alternatives that deliver information instantly and more directly to the recipient.

As private sector solutions provide a better overall value proposition for many communications, the value proposition of the USPS, as a government entity, should focus on needs not met by the private sector. Consistent with the public policy goal of correcting market inefficiencies, the USPS's value proposition should be defined as providing a safety net of necessary postal services. As discussed more fully in the USO chapter, the USO should be clarified to give preferences to specific mail and package services for which there remains a compelling government interest to provide least-cost delivery services as part of this safety net, what we will call "essential services."

### Business Objective

The main business objective of the traditional postal model is to promote national cohesion through social interaction and economic transactions. Statutes define this objective to "bind the Nation together" by delivering printed matter and small parcels for all public and private activities. Although the USPS remains central to the nation's social structure and continues to process important transactional mail, particularly for the government and for small- and medium-sized businesses, its role in promoting national cohesion has diminished relative to its historical role, and it is no longer the primary institution that binds the nation. Other media and transportation services are increasingly fulfilling this role.

Nevertheless, the USPS's comprehensive delivery network that covers every address in the country is a critical part of the nation's infrastructure that cannot be replicated by private actors, or, for the foreseeable future, displaced by emerging delivery technologies. The Task Force believes that maintaining this critical infrastructure as a national resource should be considered the primary business objective of the USPS under its new business model, even as it adopts a narrower public policy goal and a more targeted value proposition. A business model that is based on serving as an essential service provider can support the stewardship of this infrastructure, provided that the USPS makes accommodating changes to its pricing, costing, customer, and revenue strategies.

### Competitive Strategy

The competitive strategy of the statutory monopoly business model is to (1) suppress direct competition by enforcing the legal barrier that prevents other firms from entering the market for mail delivery, and (2) generate consistent revenue based on the lack of substitutes for mail. This strategy has become largely irrelevant, given the displacement of the mail market by the digital communications market. One potential alternative strategy is to leverage the expanding e-commerce delivery market to offset the decline in mail revenue with increases in package revenue. The Task Force believes that pursuit of this alternative alone, without making other needed changes, will fail as a competitive strategy as the current operating margins in the package business are far below those in the USPS's mail business, and the decline in mail volume will exceed any potentially offsetting increases in package volume for the foreseeable future.

Rather, the USPS's new competitive strategy must be consistent with a new public policy goal of correcting market failures. The Task Force believes that the competitive strategy of the new business model should leverage the USPS's national delivery network in order to generate increased revenue from both mail and package transactions that are purely commercial, such as marketing mail and most forms of e-commerce package delivery. This increased revenue from purely commercial use of the USPS and its infrastructure can be used to help pay for the costs of mail and package delivery for which there is an essential service need, and therefore a strong rationale for government support, such as for household delivery of pharmaceuticals.

### System Subsidy Model

A subsidy model implicit in many utility services, including national postal systems, is used to defray the higher costs of service to sparsely populated areas through revenues generated from more densely populated areas that have lower costs for service. This internal subsidy has always existed within the U.S. Postal System and the pricing structure of the mail monopoly. Indeed, as long as the USPS retains a national delivery network and an obligation to deliver to all addresses in the country, some form of this subsidy is logical. Nevertheless, as mail volume has declined, the revenue from densely populated areas has become insufficient to offset the delivery costs in sparsely populated areas, leading to the USPS's financial instability.

The competitive strategy – that of generating more revenue from commercial mail and packages in order to defray the cost of delivering socially important mail and packages that provide essential services – introduces a second form of internal subsidy that may be more important to the USPS's future business model. Many of the Task Force's proposed reforms to pricing, costing, and services are designed to create such a transfer of value from commercially oriented products to socially oriented essential services. To achieve financial stability, the USPS will need to maximize this new form of value transfer.



### Key Products

Mail is the key product upon which the existing business model is based. For example, in FY 2007, mail represented approximately 89 percent of postal revenues, and parcels represented a secondary product constituting 11 percent of revenues.<sup>116</sup> As a result, most historical decisions about the postal infrastructure and finances have been driven by mail product considerations. However, mail is now in structural, irreversible decline, and the point at which package revenue will exceed mail revenue is fast approaching.

Under the new business model, the growing package business will represent the key products that drive the USPS's decisions and policies, including the structure of the fleet, labor force, processing facilities, cost allocation, pricing, and regulatory requirements. This shift represents not only a change to the USPS's relative product focus, but also a change in management philosophy and culture from a monopoly activity to a more commercial activity.

### Key Customers

The traditional USPS business model does not identify key customers, in that the USPS provides services without distinguishing among the entire U.S. population of citizens, businesses, and governmental entities. Generally uniform products, pricing, access, and service standards do not allow the USPS to differentiate customers in order to generate more revenue or reduce operating costs. However, the presumption of uniform treatment, and the inability to develop strategies to differentiate customer segments, has become an obstacle to the USPS's viability.

Under the new business model, the Task Force believes that the USPS's key customers will be the citizens and businesses underserved by the market, or for whom there is a strong rationale for government support or subsidy. Although the USPS must still serve all citizens and businesses in the country, its goal with respect to commercial mailers and shippers must be to optimize long-term revenue based on market principles, rather than to ensure access to a rate-regulated, uniform government service. To be clear, the USPS should not single out individual commercial customers for disparate treatment. Rather, it must better differentiate its strategies for commercial customers that use postal services based on a return on investment, versus customers who use postal services because they have no other delivery options.

### Regulatory Mandate

Under the current business model, the regulation of the USPS is needed to protect customers and competitors from predatory monopoly practices. Captive mail customers are protected through rate caps, and competitors in the package delivery industry are protected

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<sup>116</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2007*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2007.pdf>.



by rate floors. However, because the postal mail monopoly is increasingly ineffective and the USPS is at risk of a liquidity crisis, the need to constrain the USPS's market power is now less of a regulatory concern. Moreover, the USPS's general shift from monopoly mail products to competitive package products has exposed gaps in the regulatory model. The PRC's authority to enforce institutional cost recovery requirements for competitive products may be an insufficient tool to ensure that the USPS does not distort competitive markets.

The mandate for regulating the USPS must be updated with the other components of the postal business model. New regulatory authorities should allow for oversight of how the USPS corrects market failures and implements a redefined USO. These authorities should also be broad enough to oversee the USPS's growing role as a competitor to private package delivery firms and to prevent distortion of the e-commerce delivery market.

### Revenue

The USPS's historical business model assumes that postal revenues are not directly subject to market dynamics, but rather will grow in tandem with population and GDP. This assumption informs many other aspects of the USPS's business model, most importantly its labor model and cost structure. But, the historical correlation between the USPS's revenues and overall demographic and economic forces no longer applies. Since the last recession, the economy has grown 18.7 percent and population 6 percent, while USPS revenues have fallen 6.7 percent from their peak in 2008.<sup>117,118,119</sup> Revenues are now largely a function of customer preferences and market forces, not demography.

Mail revenue is in permanent structural decline due to the preference for digital correspondence, and package revenue is now generally subject to market demand and competing offerings from national, regional, and local delivery companies. Therefore, the new business model must assume that mail revenue will continue to decline until it reaches a theoretical floor, and that package revenue will ebb and flow, depending on the prevailing competitive dynamics. All other components of the model – most importantly the USPS's competitive strategy and cost structure – must be adjusted accordingly to achieve long-term sustainability.

### Costs

The USPS's current business model assumes that costs are a function of postal volume. However, because postal volume increased for the better part of two centuries along with the nation's population and economy, the model also implicitly assumes that costs, on a

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<sup>117</sup> Bureau of Economic Analysis, *National Accounts, Gross Domestic Product*, available at: <https://www.bea.gov/data/gdp/gross-domestic-product>.

<sup>118</sup> United States Census Bureau, *Annual Population Growth*, available at: <https://www.census.gov/programs-surveys/popest/data/data-sets.html>.

<sup>119</sup> United States Postal Service, *Form 10-K Reports 2007-2017*, available at: <http://about.usps.com/who-we-are/financials/>.

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structural basis, will always trend up over time. As a result, the USPS does not have sufficient institutional mechanisms to control its costs in response to the historic secular decline in postal volume.

For the USPS to become a sustainable entity, the new business model must permit the USPS to actively contain and reduce its costs as its mail volume declines and as competitive pressures in the package markets dictate. The Task Force believes that the USPS must operate in a more cost-efficient manner by exercising discretion to lower service standards and to increase the use of third parties through additional work sharing and the use of third party processing and logistics providers. In addition, as postal employees are part of the U.S. federal civil service, their wages and benefits should be aligned to comparable U.S. federal employee groups, including aligning their ability to collectively bargain for wages and benefits with other federal employees.

### Pricing

The current business model caps price increases for mail products at the consumer price index for all urban customers (CPI-U). This rate cap, similar to those placed on other monopoly utilities, was established in order to enforce cost discipline on the USPS and to protect captive customers at a time when volumes were near their historical peak and the mail monopoly was still effective in producing revenues. However, given that the USPS has passed the historic inflection point and volumes and revenues are in persistent decline, the concept of an across-the-board rate cap is less necessary to constrain predatory pricing and is inconsistent with a sustainable postal system.

Under the new business model, purely commercial use of the postal system that is based on achieving a return on investment, such as sending marketing mail, should be priced without a rate cap and with the aim of optimizing long-term revenue. For non-commercial mail, consumer notices, and transactional mail (i.e., billing and payments), the justification for rate caps remains given the new public policy goal embodied in the updated business model that would continue to offer pricing protection for mail that represents an essential service. Similar to mail pricing, purely commercial use of package delivery services should be priced with the intent of optimizing revenue.

## Universal Service Obligation

### A. Overview

A universal service obligation (USO) is a set of requirements meant to ensure that all users of a system receive a minimum level of service at a reasonable price. A USO is enacted when there is a concern that, without such requirements, providers would choose to cut services or raise prices in high-cost areas. USOs are common in regulated industries such as the postal, telecommunication, and electric utility industries.

The law states that the USPS's basic function is “to provide postal services to bind the Nation together” through the provision of “prompt, reliable, and efficient services to patrons in all areas....”<sup>120</sup> The statute instructs the USPS to pay particular attention to ensuring a “maximum degree of effective and regular postal services to rural areas, communities, and small towns.”<sup>121</sup> Historically, this language has been interpreted to oblige the USPS to provide universal postal service throughout the United States.

### B. Background

#### Definition of the USO

The postal system's USO is not explicitly defined by statute. Rather, it is based on interpretations of various laws, regulations, operating procedures, and customs developed over time. The USO is understood to be an obligation of the USPS to provide affordable, quality postal services throughout the United States, six days a week. However, there are only four specific circumstances in which legislation includes language that characterizes the current USO:

1. To provide six-day delivery and rural delivery of mail at not less than the 1983 level;<sup>122</sup>

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<sup>120</sup> 39 U.S.C. § 101(a). The law also provides that the “costs of establishing and maintaining the Postal Service shall not be apportioned to impair the overall value of such service to the people.”

<sup>121</sup> 39 U.S.C. § 101(b).

<sup>122</sup> U.S. Government Publishing Office, *Treasury, Postal Service and General Government Appropriations Act, 1989*, Pub. L. No. 100-440, 102 Stat. 1721 (Sep. 22 1988), available at: <https://www.gpo.gov/fdsys/pkg/STATUTE-102/pdf/STATUTE-102-Pg1721.pdf>. For years, Congress has annually required 6-day delivery of mail and rural delivery to continue at not less than the 1983 level.

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2. To provide postal services for certain types of mail at geographically uniform rates;<sup>123</sup>
3. To follow certain procedures in closing post offices;<sup>124</sup> and
4. To price market-dominant products in accordance with price caps, subject to modification by the PRC.<sup>125</sup>

Beyond these requirements, postal USOs throughout the world are generally understood to include attributes such as geographic scope, range of products, access, frequency and mode of delivery, pricing, and quality. While many countries address these requirements in very specific terms, this is not true for the United States. For example, the law defines geographic scope for the USPS broadly as to “receive, transmit, and deliver throughout the United States, its territories, and possessions...written and printed matter...”<sup>126</sup> U.S. law and regulations do not address the number of, or distance between, post offices and collection boxes, as is common in other countries.

### Funding the USO

Traditionally, postal monopolies have been the most common method for funding postal USOs around the world. In the United States, the USPS has two legal monopolies – a monopoly on most letter mail, and a monopoly on delivery to the mailbox. The letter monopoly was originally established in 1792 under the Private Express Statutes.<sup>127</sup> The current statutes and regulations prohibit any entity, other than USPS, to send or carry letters over regular postal routes for compensation without the payment of postage at least equal to the amount that would have been made had the USPS carried the letter.<sup>128</sup> In 1934, Congress enacted a law known as the “mailbox restriction,” which prohibits any entity other than USPS from placing or collecting unstamped mailable items in or from customer mailboxes.<sup>129</sup> What is now known as the “mailbox monopoly” was originally intended “to protect postal revenue by preventing delivery of unstamped matter to mailboxes, which reportedly was having a considerable impact on postal revenues.”<sup>130</sup>

Historically, these two monopolies have helped USPS cover the cost of its USO. However, declining mail volume and caps on pricing now threaten the ability of the monopoly mail

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<sup>123</sup> 39 U.S.C. § 404(c).

<sup>124</sup> 39 U.S.C. § 404(d).

<sup>125</sup> 39 U.S.C. § 3622.

<sup>126</sup> 39 U.S.C. § 403(a).

<sup>127</sup> United States Postal Service, *Universal Service and the Postal Monopoly: A Brief History*, (October 2008), available at: <https://about.usps.com/universal-postal-service/universal-service-and-postal-monopoly-history.txt>.

<sup>128</sup> See 18 U.S.C. §§ 1693 – 1699; 39 C.F.R. Part 310.

<sup>129</sup> 18 U.S.C. § 1725.

<sup>130</sup> United States General Accounting Office, *U.S. Postal Service: Information About Restrictions on Mailbox Access*, GAO/GGD-97-85 (May 1997), available at: <https://www.gao.gov/assets/230/224237.pdf>.

products to provide sufficient funding for the USO. Other countries have addressed declining revenues by introducing greater pricing flexibilities. However, the success of pricing flexibilities is dependent on customer tolerance for price increases.<sup>131</sup> Data indicates that the USPS's market-dominant products are largely price-inelastic, meaning that price increases (within a certain range) can boost overall revenue, as they will not be fully offset by demand reductions.<sup>132</sup> As such, given current elasticity estimates, moderate price increases on letter mail would likely lead to an increase in revenue.<sup>133</sup>

### C. Findings and Recommendations

***Without a clearly defined USO, it is difficult for the USPS to make business decisions in a timely and efficient manner. The USO must be clearly defined.***

The USO effectively represents a mission statement for a country's postal system, defining what citizens and businesses need from a government provided postal service. As noted above, in the United States, the USO is not specifically defined in any one document and is subject to different interpretations.

For the USPS's business model to achieve sustainability, the Board should work to define the USO with greater specificity or seek legislation to do so. The Task Force believes that the most important aspect of this definition is to distinguish between the types of mail and packages that represent an essential service for which a strong social or macroeconomic rationale exists for government protection or subsidy – in the form of price caps and mandated delivery standards. These would be distinguished from those types of mail and packages that are commercial in nature, and therefore would not have a basis for similar government protection. This will provide a targeted definition of minimum essential services that the government should require the USPS to provide. For example, items included as essential services could consist of all personal correspondence (person-to-person mail), transaction mail (bills, financial statements, product recall notices), government mail

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<sup>131</sup> United States Postal Service, Office of Inspector General, *Funding the Universal Service Obligation*, RARC-WP-16-005 (Mar. 21, 2016), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-005.pdf>. For example, the OIG notes that existing mailers of monopoly products who already generate most of USPS's contribution to institutional costs may not want to take on the additional burden of funding the USO through price hikes. If customers have low tolerance for price increases, any increase may have to be combined with direct subsidy and diversified revenue streams.

<sup>132</sup> United States Postal Service, Office of Inspector General, *Analysis of Postal Price Elasticities*, RARC-WP-13-008 (May 1, 2013), available at: [https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-13-008\\_0.pdf](https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-13-008_0.pdf).

<sup>133</sup> United States Postal Service, Office of Inspector General, *Funding the Universal Service Obligation*, RARC-WP-16-005 (Mar. 21, 2016), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-005.pdf>.

(election and tax related mail), parcels containing pharmaceuticals, and parcels sent from consumer to consumer.

***With over 60 percent of counties and 14 percent of the population classified as rural, the geographic scope of the USO should continue to be defined to include all addresses in the United States.***

The statute requires the USPS to receive, transmit, and deliver mail throughout the United States, its territories, and possessions.<sup>134</sup> It also requires transmission of military mail throughout the world.<sup>135</sup> Eliminating these services would weaken ties between remote or rural areas and the rest of the nation, thus raising the private cost or public subsidy needed to serve rural and remote areas.

The USO should continue to be defined to include all addresses in the country covering “the United States, its territories and possessions”<sup>136</sup> irrespective of population density as well as transmission of military mail throughout the world. The cost of sending and delivering products, defined as essential services, should be standard, regardless from where the products are sent or delivered – similar to the current flat postage rate for First-Class Mail.

***Statutes impose generic, minimal requirements for access to the postal system, but do not require a certain number of post offices or collection boxes. The USPS needs a clearly defined USO standard for delivery.***

Current law only obligates the USPS to establish and maintain postal facilities of such character and in such locations so that “postal patrons” have “ready access to postal services” that is “consistent with reasonable economies.”<sup>137</sup> The specific parameters of this obligation are not clearly defined. Currently, mailers access universal postal services by one of three methods: 1) depositing mail at a post office or postal facility, 2) depositing mail in a public collection box, or 3) placing mail in a private mailbox for collection by a mail carrier. Although USPS has the authority to determine the need for post offices and is authorized to close and consolidate post offices when they are no longer needed, current law provides that “no small post office shall be closed solely for operating at a deficit.”<sup>138</sup>

The Task Force believes that there should be a clearly defined USO standard for access. The USPS should have the flexibility to determine the number of post offices and collection boxes as long as it meets the defined standard of access and is consistent with a financially sustainable business model.

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<sup>134</sup> 39 U.S.C. § 403.

<sup>135</sup> 39 U.S.C. § 406.

<sup>136</sup> 39 U.S.C. § 403.

<sup>137</sup> Ibid.

<sup>138</sup> 39 U.S.C. § 101(b).



***Although the USPS has broad discretion over the mode of delivery, Congress annually mandates that USPS deliver mail six days per week. USPS should have greater flexibility for determining delivery frequency.***

The statutes are silent on the frequency of delivery which the USPS is obliged to provide. This broad discretion is constrained by one provision, which has been included in the USPS annual appropriation for years: a requirement to maintain “six-day delivery and rural delivery of mail...at not less than the 1983 level.” Unfortunately, there is no readily-available data regarding what constitutes the “1983 level.” In 2013, the USPS and the Congressional Budget Office (CBO) each estimated that the annual savings from moving mail delivery (not including packages) from six-days to five-days a week would save \$1.5 billion and \$1.2 billion respectively.<sup>139</sup> The expected savings, if calculated today, would likely be less than previous estimates due to changes in the USPS’s labor model (driven primarily by the utilization of more non-career employees) and the trend toward faster and more frequent delivery standards (within the parcel market in particular).

Given changing preferences for delivery frequency, the Task Force believes that the USPS should have greater flexibility to determine what its delivery frequency should be. Delivery frequency could differ depending upon the product. For example, for items deemed essential services, the USPS should determine a delivery frequency that is commensurate with the social and economic needs specified for those items. For items not deemed essential services, the USPS should determine a delivery frequency that optimizes the generation of net income, while still achieving customer expectations.

***Current statutes afford the USPS the discretion to determine the delivery mode, based on reasonableness and efficiency, including door-to-door, curbside, and centralized delivery. The USPS should maintain and use its discretion to determine the mode of delivery that is consistent with developing and maintaining a financially sustainable business model.***

The specific parameters of delivery modes are not clearly defined in existing law. Currently, delivery of mail occurs door-to door, via curbside mailboxes, or via centralized delivery such as cluster boxes or post office boxes.

The Task Force believes that the USPS should have the discretion to determine delivery mode. However, the USPS should be required to make the procedures and requirements for delivery modes transparent and public. The choice of delivery mode should be consistent with developing and maintaining a financially sustainable business model for the USPS and should take into consideration customer needs.

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<sup>139</sup> Congressional Budget Office, *Cost Estimate of H.R. 2748 Postal Reform Act of 2013*, (June 23, 2014), available at: <https://www.cbo.gov/sites/default/files/113th-congress-2013-2014/costestimate/hr27482.pdf>.



***As speed of processing is less important to mailers than geographic coverage, predictability, and frequency of delivery, the USPS should retain discretion to determine processing speed.***

The law requires the USPS to provide “adequate and efficient postal services” and “prompt, reliable, and efficient services.”<sup>140</sup> PAEA requires the USPS to promulgate “modern service standards,” which has been interpreted as publishing “stated goals” for transit times of different products.<sup>141</sup>

The Task Force’s outreach with major mailers revealed that geographic coverage, predictability on timing of delivery, and six-day delivery are more important than the speed of delivery. Mailers can, in many cases, adjust drop-off dates to accommodate slower or faster delivery. As such, the Task Force recommends that processing standards be transparent, public, and measurable, with the USPS determining processing standards that are consistent with a financially sustainable business model.

***Although the USO has historically been funded by the mail monopoly, revenue generation outside of the mail monopoly will continue to become increasingly important. The USPS should determine ways to optimize activities to cover the costs of the USO.***

Although codified in federal criminal code provisions, the USPS’s letter monopoly and mailbox monopoly serve to protect USPS’s revenues from private competitors, thereby enabling the USPS to fulfill its USO, while operating as a self-financing, independent establishment in the executive branch. The monopolies allow the USPS to earn increased revenues by charging a higher markup on monopoly products in order to offset the costs imposed on it by the USO. Substantially all of the USPS’s USO operating costs are paid for by customers through postage stamps and services. The USPS also receives a relatively small annual appropriation from the government that is funded by taxpayers, amounting to less than one-half of one percent of the USPS’s entire annual operating budget. These funds are appropriated to reimburse the USPS for revenue forgone for providing postage-free mailing services for the legally-blind and for the overseas mailing of paper election ballots.<sup>142</sup>

In a 2016 report on the USO, the USPS OIG noted that it has become increasingly difficult for the USPS to earn enough revenue through the letter and mailbox monopolies to fund the USO.<sup>143</sup> The USPS’s ability to fund the USO through these monopolies has eroded over the

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<sup>140</sup> 39 U.S.C. §§ 101(a) and 403(a).

<sup>141</sup> 39 U.S.C. § 3691.

<sup>142</sup> 39 U.S.C. §§ 2401(c), 3403, and 3406. See also Don Soifer, Consumer Postal Council, *Universal Postal Service in Major Economies* (June 2015), available at: <http://www.postalconsumers.org/wp-content/uploads/2018/01/June-2015-CPC-Universal-Postal-Service-Report.pdf>.

<sup>143</sup> United States Postal Service, Office of Inspector General, *Funding the Universal Service Obligation*, RARC-WP-16-005, (March 2016), available at: <https://www.usps.oig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-005.pdf>.

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last 10 years, during which time the decline in the volume of letter mail, the price-caps on monopoly products, and other statutory restrictions on the USPS have led to declining revenues from monopoly products, particularly First-Class Mail.

The Task Force believes that the USPS should optimize revenue and costs on products and activities not deemed essential services, in order to provide a funding mechanism for the USO.

## Mail and Package Markets

### A. Overview

The USPS projects a significant decline in mail volumes over the next ten years. The availability of e-substitutes, combined with pricing restrictions, has placed burdens on the USPS's mail revenue, while an expanding population base has led to an increase in delivery points and additional expense.

Although electronic communications have reduced mail volume and revenue, e-commerce has contributed greatly to the growth of the USPS's package volume and revenue. Pitney Bowes estimated the U.S. parcel market revenue at \$107 billion of revenue with shipment volumes of 11.9 billion packages in 2017.<sup>144</sup> Where business-to-business (B2B) shipments once constituted the vast majority of package deliveries, today, the majority of shipments are business-to-consumer (B2C).

These trends have driven the USPS toward income deficits and limited its ability to update its infrastructure with needed capital expenditures. Moreover, the USPS's business model now subsidizes an industry of mail preparers, consolidators, and direct marketers whose business models are largely dependent on rate-capped mail delivery. Entire industries have been created and nurtured via the postal system, including: 1) a paper-based direct mail marketing industry that can access rates that are lower than First-Class Mail and that are significantly lower than equivalent mail rates in foreign countries; and 2) the Mail Service Provider (MSP) industry that serves as a middleman, providing a range of services such as printing, list management, transportation, and pre-sortation of mailers (for the financial services, insurance, and other industries) to the USPS.

Under the USPS's current operating model, the projected declines in mail revenue and income will not be fully offset by the projected increases in revenues resulting from increased package volumes, given the margins currently associated with each segment. Also, without a clearly defined USO, and significant changes to the USPS's mail segment pricing model, expense controls, and cost allocation methods, the USPS's long-term sustainability is in question.

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<sup>144</sup> Pitney Bowes, *Pitney Bowes Parcel Shipping Index*, available at: <https://www.pitneybowes.com/us/shipping-index.html>.

## B. Background

### Key Mail Trends

Although Marketing Mail volume is expected to continue to increase over the next ten years as a share of total mail, First-Class Mail is projected to continue to decline.<sup>145,146</sup> This decrease in First-Class Mail, which represents the majority of USPS revenue, is irreversible. As the migration from paper to electronic communication continues to evolve, trends in mail usage are likely to have a significant adverse effect on USPS's cash flows.

There is a widely held perception that, as a greater number of digital alternatives to mail become available, postal demand sensitivity to price should increase. However, there is insufficient data to fully predict consumer responses to price changes of mail products, and there is disagreement on the methodology and impact on product price elasticities. The USPS OIG found that demand for mail products and services has not been getting more elastic over time, which implies it is possible to raise revenue through price increases on letter mail.<sup>147</sup> The OIG's study showed that for Single Piece Letters, Flats, and Parcels, demand has been stably inelastic. Rather, the reduced mail volumes has been the result of other factors, such as the availability of digital alternatives, and is not likely tied to postage price increases. The mailers who continue to utilize conventional mail do so because they are either traditionalists or do not have an effective alternative, irrespective of price.

### *Competition and Workshare*

The USPS does not have formal competition in the mail market due to its letter and mailbox monopoly. However, several of the USPS's competitors and partners service portions of the mail value chain (i.e., through worksharing). These firms also have nationwide printing, transportation, and processing networks that rival those of the USPS.

As described by the PRC: "Workshare discounts provide reduced prices for mail that is prepared or entered in a manner that avoids certain activities the Postal Service would otherwise have to perform. These discounts are based on the estimated avoided costs that

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<sup>145</sup> United States Postal Service, *United States Postal Service FY2017 Annual Report to Congress*, available at: <https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

<sup>146</sup> United States Postal Service, *Accomplishing Postal Reform in the 115<sup>th</sup> Congress – H.R. 756, the Postal Service Reform Act of 2017: Hearings before the House Oversight and Government Reform Committee Hearing*, United States House of Representatives, 115<sup>th</sup> Congress, Testimony of USPS Postmaster General and Chief Executive Office, Megan J. Brennan (Feb. 7, 2017), available at: [https://about.usps.com/news/testimony/2017/pr17\\_pmg0207.pdf](https://about.usps.com/news/testimony/2017/pr17_pmg0207.pdf).

<sup>147</sup> United States Postal Service, Office of Inspector General, *Funding the Universal Service Obligation*, RARC-WP-16-005, (March 21, 2016), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-16-005.pdf>.

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result from the mailer performing the activity instead of the Postal Service.”<sup>148</sup> For example, MSPs provide services that enable access to the mail, including designing, printing, transporting, and preparing of mailings.

The USPS also contracts directly with third parties for key value chain processes such as transport. Private companies carry USPS mail, all packages that travel by air, and almost all packages that travel by inter-city truck transportation. From FY 2008 to 2017, the USPS revenue generated from workshared mail products, as a percent of total mail revenue, increased from 65 percent to 70 percent, and the volume of workshared mail products, as a percent of total mail products, increased from 80 percent to 85 percent.<sup>149</sup>

Other participants with the capability to participate in the mail market include newspapers and package delivery companies. Package delivery companies (e.g., UPS, FedEx, and LaserShip) have established national or regional networks and, with acquisitions of automated mail processing machinery, could conceivably participate in multiple parts of the mail value chain without violating the USPS’s monopoly.

### Key Package Trends

The USPS remains an important service provider for traditional person-to-person package delivery. This includes 418 million packages sent by households through the USPS in FY 2017 (either to other households or to businesses).<sup>150</sup> Although households receive about ten times more packages than they send, the USPS is especially critical to households that operate small-scale businesses (e.g., through eBay and Etsy).

With the growth of e-commerce, market participants are increasingly focused on expanding their urban, B2C delivery businesses. Growth in the B2C market has stretched the capacity of existing package delivery companies and attracted new entrants to the market. It has also led to the development of new transportation and package processing technologies, such as delivery drones, mobile package lockers, and advanced package processing capabilities. The USPS has invested in some technologies such as GoPost lockers and autonomous mobile robots for mail and package sorting.<sup>151</sup> However, the USPS cost allocation methods and its

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<sup>148</sup> Postal Regulatory Commission, *United States Postal Service FY 2017 Annual Compliance Determination Report*, available at: [https://www.prc.gov/docs/104/104398/2017\\_ACD.pdf](https://www.prc.gov/docs/104/104398/2017_ACD.pdf).

<sup>149</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) Reports: 2008-2017*, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>150</sup> United States Postal Service, *The Household Diary Study: Mail Use and Attitudes in FY 2017*, (March 2018), available at: [from https://www.prc.gov/docs/105/105134/USPS\\_HDS\\_FY17\\_Final%20Annual%20Report.pdf](https://www.prc.gov/docs/105/105134/USPS_HDS_FY17_Final%20Annual%20Report.pdf).

<sup>151</sup> United States Postal Service, Office of Inspector General, *Autonomous Mobile Robots and the Postal Service* RARC-WP-18-006, (April 9, 2018), available at: <https://www.uspsaig.gov/sites/default/files/document-library-files/2018/RARC-WP-18-006.pdf>.

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current and projected liquidity constraints limit its ability to compete with the private sector in the development and implementation of new delivery technologies.<sup>152</sup>

Package size and weight have become more standardized as e-commerce markets have grown, resulting in market participants investing in infrastructure, such as delivery vehicles and processing systems of their own. The growth in delivery densities, determined by a combination of the time and distance between delivery points and the volume of products delivered, has also prompted technological innovations, such as mobile package lockers and drone delivery. Notably, several companies focus on same-day delivery services for time-sensitive products, such as groceries and pharmaceuticals.

In addition, the USPS has negotiated service agreements (NSAs) in place with many small businesses for delivery services. These agreements allow small businesses to achieve some economies of scale in delivery, as they are typically unable to do so through their own delivery network.

### *Seasonal Capacity Constraints*

Package carriers are struggling to provide the needed capacity to handle the rapid growth in package markets, especially in the October through December seasonal market. As package markets have shifted away from shipments between businesses (B2B) and toward e-commerce delivery (B2C), package volume has become characterized by greater seasonality. Over 30 percent of USPS package shipments occur in the last quarter of the year, reflecting holiday sales.<sup>153</sup> During holiday periods, shippers are often required to add capacity to meet demand, such as by adding Sunday delivery services or hiring additional non-career, temporary employees. Private package delivery companies often rely on the USPS's Parcel Select service to meet their seasonal demand. The USPS's Parcel Select volumes are about 20 percent higher on average in the last quarter of the calendar year.<sup>154</sup>

### *Customer Expectations*

Customers increasingly expect faster and more frequent e-commerce delivery. In the early 2000s, a customer's expectations for free delivery from a retailer typically meant receiving a package in 7-10 days. Today, many major retailers offer free two-day delivery for a range of purchases. Warehouses and fulfillment centers have been decentralized and located closer to local markets, and companies are increasingly expanding weekend delivery services, package tracking, and route optimization in order to better fulfill customer demand.

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<sup>152</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2017*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

<sup>153</sup> United States Postal Service. *Revenue, Pieces and Weight (RPW) Reports 2012-2017*, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>154</sup> United States Postal Service. (2017). *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/>.

However, there are limits to how much consumers are willing to pay for delivery. In general, e-commerce consumers remain highly sensitive to delivery costs. Roughly 70 percent of consumers choose their delivery option and location (e.g., to a package locker) based on price, or choose the cheapest option for home delivery, as opposed to choosing based on speed of service.<sup>155</sup> This often means 2-5-day delivery. Consumers also prefer home delivery over delivery to parcel lockers or other central locations.<sup>156</sup>

### C. Findings and Recommendations

***The USPS mail business is not sustainable under the existing operating model. USPS should develop a new model for setting rates and controlling costs to achieve sustainability.***

In general, statutory price caps and pricing uniformity are inappropriate constraints if the mail business is no longer able to function as a monopoly. In the current declining mail volume environment, price caps prevent the USPS from making needed adjustments that could alleviate the increasing gap between the USPS's costs and revenues. In FY 2017, several mail products did not generate income sufficient to cover attributable costs.<sup>157</sup> As such, increases in attributable costs and expenses, combined with declining revenues, led to significant declines in mail products' contribution to the USPS's institutional costs. Simply raising rates on mail products within the USPS's current model would be insufficient.

A floor likely exists below which First-Class Mail per capita will not fall, as one would expect a subset of steady users of marketing mailers, consumer and business correspondence, and government communications, to ensure a minimum level of mail. For example:

- Non-profit organizations rely heavily on donations received through traditional mail, and their attempts to replace mail with online solicitations have yet to result in levels of donations commensurate with traditional mail.
- For consumer and business mail recipients, a subset will continue to demand that paper bills and statements be delivered (i.e., to possess a hard copy record, irrespective of any online mechanism).

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<sup>155</sup> McKinsey & Company, *Parcel delivery: The future of last mile*, (September 2016), available at: [https://www.mckinsey.com/~media/mckinsey/industries/travel%20transport%20and%20logistics/out%20insights/bo n%20customer%20demands%20are%20reshaping%20last%20mile%20delivery/parcel\\_delivery\\_the\\_future\\_of\\_last\\_mile.asbx](https://www.mckinsey.com/~media/mckinsey/industries/travel%20transport%20and%20logistics/out%20insights/bo n%20customer%20demands%20are%20reshaping%20last%20mile%20delivery/parcel_delivery_the_future_of_last_mile.asbx).

<sup>156</sup> Ibid.

<sup>157</sup> Postal Regulatory Commission, *Fiscal Year 2017 Financial Analysis of the United States Postal Service, Financial Results and 10-K Statement*, available at: <https://www.prc.gov/docs/104/104498/PRC%20FY2017%20FINANCIAL%20REPORT%20FINAL.pdf>.



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- Small and local businesses may still see the value of mail relative to television and digital advertising due to reduced mailbox competition.
- Certain federal and local governmental communications and transactions, such as local taxes, registrations, or other national mailings for investment and regulatory filings, will likely continue.

The USPS's data indicates that mail is largely price-inelastic, meaning that modest price increases can boost overall revenue because they would not lead to less demand for the products or services. Given this fact, the Task Force recommends that the PRC use the full extent of their authorities to establish a new system for regulating rates and classes for market dominant products for the purpose of enabling rate increases that would increase the USPS's net income.

***The benefits of the USPS monopolies continue to diminish. The USPS must pursue price increases, reduce service costs, or exit the business line for any class of mail that falls outside of the determined essential services and that does not cover attributable costs.***

With the erosion of monopoly benefits due to the emergence of substitutes to USPS mail products, historical concerns of pricing abuse by the USPS are diminished, as is the need for price regulation. Specifically, rate caps should be eliminated for Marketing Mail and any mail outside of the defined essential services. Although Marketing Mail generates a positive net income, it is still subject to price caps. There is little public policy justification for the federal government to maintain price caps on commercial marketing solicitations. An opportunity exists to eliminate or relax price caps and appropriately price Marketing Mail, thereby increasing the USPS's net income in order to compensate for losses associated with other products, deemed essential services, where a strong social or macroeconomic rationale exists for government protection or subsidy.

The Task Force recommends that the USPS be required to price any mail not deemed to be an essential service at a market rate in order to generate income that would fund the USO, capital expenditures, and other long-term liabilities. The USPS should incorporate minimum "essential" package services into the definition of the USO, such as for the delivery of pharmaceuticals and non-commercial, person-to-person packages. Redefining the mandate for USPS package delivery business will provide a funding mechanism for the USO.

USPS categorizes products by type rather than purpose. Mail product classes should be redefined by creating products that are defined by the type of sender and the purpose (e.g., correspondence, transaction mail) of the mail item.

USPS manages, prices, and tracks data based on products that are defined by their physical characteristics (i.e., shape and weight), rather than making decisions based on the purpose and end uses of mail (i.e., marketing mail, household correspondence, legally required correspondence). The USPS conducts an annual survey of households in order to determine

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the contents of mail and packages sent and received. Data collected by the USPS in this annual household survey on consumer and business mailing behavior does not play a significant role in the cost-assessment or pricing of USPS products.

The USPS OIG notes that understanding what mail recipients want to receive could generate significant benefits for all participants in the postal market: mailers would get better responses to targeted mailing through improved information on customer preferences, recipients would benefit from receiving mail that better serves customer needs, and the USPS would benefit from higher value mail products.<sup>158</sup>

The Task Force recommends that the USPS should be required to improve its data tracking systems to track the purposes and uses of mail, allowing for better cost allocation, targeted pricing, and detailed business intelligence.

***Despite the mail monopoly, the end-to-end mail value chain (origination, pick-up/collection, processing, transportation, and delivery) is divisible and has many suppliers and competitors. To achieve more cost efficiencies, the USPS should expand third-party relationships.***

With improvements in technology and supply chain logistics, the current mail value chain continues to evolve from one that was solely owned and operated by the USPS to one that is operated with partners and suppliers, often within discrete elements of the supply chain. For example, pick-up and delivery, while currently covered by the letter and mailbox monopoly and performed with internal USPS staff and equipment, has an ecosystem that is complementary to package companies. Given the opportunity, these companies could also pick-up and deliver mail products given the opportunity.

Third-party providers process and transport mail more efficiently than the USPS. For example, MSPs already: 1) produce (print, manage lists, sort) much of the pre-sort volume down to 3- and 5-digit zip codes for the USPS; 2) have numerous facilities that provide downstream printing and processing; 3) use and sometimes manufacture the same equipment to pre-sort mail that the USPS uses to process it; and 4) can acquire trucks and drivers.

The USPS's greatest comparative advantage is in the delivery of letter and flat products at lower costs than their competitors, given the obligation to stop by every mailbox, six days per week. The Task Force recommends that the USPS continue to expand its use of third-party relationships in order to provide services in a more cost-efficient manner (e.g., mid-

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<sup>158</sup> United States Postal Service, Office of Inspector General, *Strengthening Advertising Mail by Building a Digital Information Market*, RARC-WP-14-002, (December 11, 2013), available at: [https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-002\\_0.pdf](https://www.uspsoig.gov/sites/default/files/document-library-files/2015/rarc-wp-14-002_0.pdf).

stream logistics and processing). For example, roughly 85 percent of USPS mail volume already utilizes some level of third-party mid-stream processing and sortation.<sup>159</sup>

***The legal mailbox monopoly remains highly valuable. As a means of generating more income, the mailbox monopoly could be monetized.***

The USPS's exclusive access rights to mailboxes protects customers from theft, obstruction, fraud, and other mail-related criminal activity while protecting the personal privacy of consumers.<sup>160</sup> The mailbox monopoly also provides advantages to the USPS for the delivery of packages small enough to fit in a mailbox. As MSPs and package delivery companies continue to expand offerings to multiple parts of the value chain, it is reasonable to expect a willingness to pay for access to USPS mailboxes. By franchising the mailbox, the USPS could expand its revenue and income opportunities without necessitating any change to its current mail products.

The Task Force recommends that the USPS explore franchising the mailbox as a means of generating revenue. This could be done by retaining the mailbox monopoly and allowing regulated access, for a fee, to certified private companies. These "franchisees" would be granted access to the mailbox for the delivery of mail and small parcels.

***The USPS has a dominant market position in B2C e-commerce segments and can take advantage of lower delivery costs and mailbox access. The USPS should price these competitive products to generate income rather than maximize volume.***

The USPS's delivery costs are generally lower than those of other carriers due to an ability to share infrastructure costs between package and mail delivery. The bulk of the USPS's package delivery volume consists of small parcels and "last mile" delivery, where packages are delivered to a local USPS distribution facility in bulk, for final delivery.

As package markets grow, delivery densities are increasing in urban and suburban areas, reducing delivery costs to those markets. As delivery densities rise and delivery costs fall, the USPS's cost advantage from shared mail and package delivery infrastructure will continue to decline, and could even fully disappear. As a result, areas with higher delivery density tend to be characterized by higher levels of competition and a greater diversity of delivery options.

However, in rural areas with greater distances between delivery points and fewer packages per stop, the USPS continues to fulfill most deliveries. The proximity of local post offices

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<sup>159</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2017.pdf>

<sup>160</sup> ILO Institute, *The Mailbox Monopoly: A New Look at the Last Mile*, (February 8, 2008), available at: <https://about.usps.com/universal-postal-service/ilo-report.pdf>

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across the country also increases the convenience of package pickup and drop-off in rural areas when home delivery is not viable.

The Task Force recommends that USPS price its competitive products in a manner that is not geared simply toward maximizing volume, but instead toward generating income that can be used to fund its capital expenditures and long-term liabilities. Alternatively, the Task Force recommends that in any of its pricing decisions, the USPS consider the potential market distortions that could drive industry participants out of the market.

***While there is no direct financial subsidy of competitive products, mail products and the mailbox monopoly allow for an indirect delivery subsidy. The USPS needs to provide full price transparency and fully distribute costs.***

The letter monopoly permits the USPS to share delivery costs between the USPS's package and mail segments without full cost allocation, reducing package delivery costs. Additionally, the USPS's subsidization of unprofitable mail routes with profitable ones is widely known and supported. The USPS's competitors argue that USPS leverages cross-subsidization to create unfair competition, inhibiting private sector innovation and therefore preventing lower prices for customers. The USPS's ability to price last mile delivery and the delivery of small packages below those of private sector competitors distorts package markets. The USPS can also distort markets through negotiated service agreements with individual shippers, providing lower-priced services to some shippers and not to others.

Under PAEA, market-dominant products (mainly mail) are not permitted to subsidize competitive products (mainly packages). To calculate whether market-dominant products provide a subsidy to competitive products, the USPS must separate costs for the two product lines. "Attributable costs" represent the costs which can be directly linked to a product line. "Institutional costs" are costs which cannot be directly linked to a product line, and which are shared between market-dominant and competitive products, such as shared post office space and shared delivery vehicles. Prices for competitive products must cover their attributable costs plus a portion of institutional costs in order to avoid classification as "subsidized."

The PRC set the minimum requirement for competitive products' institutional cost coverage at 5.5 percent in 2007, matching the share of institutional costs covered by competitive products at that time.<sup>161</sup> The requirement has remained at 5.5 percent since 2007, even as

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<sup>161</sup> Postal Regulatory Commission, *Order Establishing Ratemaking Regulations for Market Dominant and Competitive Products*, Docket No. RM2007-1, (October 29, 2007), available at: <https://www.prc.gov/docs/58/58026/FinalRuleswithTOC.pdf>.

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package growth has enabled institutional cost coverage at around 23 percent in FY 2017.<sup>162</sup> Appropriate institutional cost allocation is needed to ensure sufficient funding for investment in infrastructure and new technologies, as well as to ensure that there is no cross-subsidization between mail and packages.

The PRC's 2016 cost allocation model<sup>163</sup> was upheld by the U.S. Court of Appeals in May 2018.<sup>164</sup> The PRC has proposed a rule on the share of competitive product institutional cost coverage under Docket No. RM2017-1.<sup>165</sup> The rulemaking proposes that the minimum share be calculated annually according to market conditions. Specifically, the share would be calculated from a formula that is based on the size of the competitive market and the USPS's share of that market.

The Task Force recommends that the USPS be required to provide full price transparency for all package services in order to reduce market distortion. The Task Force further recommends that the USPS and the PRC develop a new cost allocation model with fully distributed costs to all products, services, and activities.

***The USPS should retain the package business but establish a separate balance sheet for packages to help prevent cross-subsidization between the mail and package business units.***

Separating and spinning off a package business from the USPS may be difficult to accomplish, given the USPS's unified labor and physical resources. Property and equipment account for 54 percent of the USPS's assets, which are often shared between mail and package functions.<sup>166</sup> Given the current structure and capacity constraints of the package market, the Task Force recommends continuing a government-supported package delivery service (at least in the short-term) to ensure that small and medium e-commerce vendors can exist alongside large e-commerce vendors.

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<sup>162</sup> Postal Regulatory Commission, *Order Concerning United Parcel Service, Inc.'s Proposed Changes to Postal Service Costing Methodologies (UPS Proposals One, Two, and Three)*, Docket No. RM2016-2, Order No. 3506, (September 9, 2016), available at: <https://www.prc.gov/docs/97/97114/Order3506.pdf>.

<sup>163</sup> Postal Regulatory Commission, *Order Establishing Rate-making Regulations for Market Dominant and Competitive Products*, Docket No. RM2007-1, (October 29, 2007), available at: <https://www.prc.gov/docs/58/58026/FinalRuleswithTOC.pdf>.

<sup>164</sup> United States Court of Appeals for the District of Columbia Circuit, *United Parcel Service, Inc. v. Postal Regulatory Commission*, 890 F.3d 1053, (Decided May 22, 2018), available at: [https://www.cadc.uscourts.gov/internet/opinions.nsf/E9845DA7ACC1A2CD85258295004D5A06/\\$file/16-1354-1732076.pdf](https://www.cadc.uscourts.gov/internet/opinions.nsf/E9845DA7ACC1A2CD85258295004D5A06/$file/16-1354-1732076.pdf).

<sup>165</sup> Postal Regulatory Commission, *Notice of Proposed Rulemaking to Evaluate the Institutional Cost Contribution Requirement for competitive Products*, Docket No. RM2017-1, (February 8, 2018), available at: <https://www.prc.gov/docs/103/103724/Order%20No.%204402.docx>.

<sup>166</sup> United States Postal Service, *Revenue, Pieces and Weight (RPW) FY 2017*, available at: <http://about.usps.com/who-we-are/financials/revenue-pieces-weight-reports/fy2017.pdf>.

# Operational Structure, Governance, and Long-term Liabilities

## A. Overview

The size and complexity of the USPS, coupled with its unique, corporate-like structure as an “independent establishment of the executive branch” that is subject to various federal statutes and regulations, has resulted in significant operational challenges.<sup>167</sup> The current operational structure assumes that mail volume and revenue will increase with population and economic growth, as they did for two centuries. The USPS is facing several significant long-term challenges, including declining First-Class and Standard Mail, the annual increase in the number of addresses to which the USPS must deliver, and the ongoing growth in long-term liabilities. This section will discuss the USPS’s operational structure, governance and regulation, and long-term liabilities, and provide recommendations to help to ensure the financial health of the USPS is restored.

## B. Background

### Operational Structure

The USPS’s operational structure enables the USPS to fulfill its mandate to “bind the Nation together.” To do so, the USPS delivers 146 billion pieces of mail and packages to more than 159 million households and businesses annually. The USPS employs approximately 634,000 people, which account for around 76 percent of the USPS’s operating costs, and operates more than 35,000 retail locations and 370 mail processing facilities.<sup>168,169</sup>

### *Operating Costs*

The USPS’s operating costs are expected to continue to grow as new delivery points are added and as the requirements for package delivery expand. The USPS projects that it will need to increase its average annual capital spending by approximately 70 percent over the

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<sup>167</sup> 39 U.S.C. § 201.

<sup>168</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>169</sup> United States Postal Service *Form 10-K reports for years 2015-2017*, available at: <http://about.usps.com/who-we-are/financials/>.



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next 10 years.<sup>170</sup> The increased spending is needed not only to account for the USPS's shifting business model, but also in order to make many critical infrastructure investments that have been deferred in recent years due to financial shortfalls. These investments include the acquisition of new delivery vehicles to replace its aging existing fleet and processing equipment that will enable the USPS to improve its efficiency.

### **Labor Costs**

Current law specifies that the officers and employees of USPS "shall be in the postal career service, which shall be part of the civil service."<sup>171</sup> Career postal employees are represented by nine unions and two management associations. Postal workers, like most federal civil service employees, participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS), as well as in the Federal Employees Health Benefits Program (FEHB), and are covered by the Federal Employees Compensation Act for workers' compensation claims. However, unlike other federal workers, the PRA authorizes collective bargaining on compensation, some benefits, and conditions of employment, and postal unions are therefore able to negotiate compensation, benefits, and working conditions.<sup>172</sup> Given their federal employee status and the role that the USPS plays in the economy, USPS employees maintain a unique collective bargaining position. They can bargain for wages and benefits as private sector unions do, without the same level of risk that their company will go out of business.

In recent years, the USPS has been able to achieve limited labor reforms. Postal salaries have risen at slower rates than those in the private sector, collective bargaining agreements have gradually transferred a portion of health premiums from the USPS to individual workers, and the USPS has been able to lower the number of employees, from a high of over 905,000 in 1999 to around 634,000 in 2018, relying more heavily on non-career employees. However, the USPS's labor costs continue to represent a significantly higher proportion of total operating costs than its private sector competitors. Additionally, "no layoff" clauses exist in many of the USPS's collective bargaining agreements, limiting management's ability to adapt the USPS's business model.

### **New Revenue Streams**

The USPS's ability to expand into competitive markets is limited. Legislation is required for the USPS to offer new non-postal or non-governmental products and services and new experimental postal products and services require PRC approval as well as extensive market testing.<sup>173,174</sup>

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<sup>170</sup> United States Government Accountability Office, *U.S. Postal Service: Projected Capital Spending and Processes for Addressing Uncertainties and Risks*, GAO-18-515, (June 2018), available at: <https://www.gao.gov/assets/700/692859.pdf>.

<sup>171</sup> 39 U.S.C. § 1001(b).

<sup>172</sup> 39 U.S.C. § 1005(f).

<sup>173</sup> See 39 U.S.C. § 404(e).

<sup>174</sup> 39 U.S.C. § 3641; 39 C.F.R. § 3035.5.

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### Governance and Regulation

There are three elements of the governance structure of the USPS, including the Governors, the PRC, and the Postmaster General.

The Governors are considered the “head of the agency” and are responsible for directing the operations of the USPS and appointing the Postmaster General. There are nine Governor positions, with staggered, seven year terms, of which no more than five can be from the same political party, and of which four must have experience overseeing large organizations. The Governors are appointed by the President and must be confirmed by the U.S. Senate.

Between December 2016 and August 2018, the Board had no Governors. In August 2018, the Senate confirmed two Governors, who were the first Governors confirmed by the Senate since 2010. A third Governor is awaiting confirmation by the Senate. Without Governors, the Postmaster General managed the USPS’s financial and operational challenges without strategic direction and guidance, exacerbating management’s limited power to effect needed organizational change.

The PRC is an independent agency that exercises regulatory oversight of the USPS price changes, costs allocations, and certain operations. It does not have regulatory authority over the full range of USPS operations. There are five Commissioner positions, of which no more than three can be from the same political party. Commissioners are appointed by the President and must be confirmed by the U.S. Senate. There are currently four PRC Commissioners, with a fifth pending confirmation by the U.S. Senate.

The Postmaster General is appointed by the Governors, under a term of service determined by the Governors, to lead the day-to-day operations of the USPS. The Postmaster General and Deputy Postmaster General are members of the Board of Governors. The current Postmaster General has held the position since 2015.

### Long-Term Liabilities

Despite the USPS’s attempts to contain labor costs, each of its three major benefit programs imposes a large long-term liability on the USPS unrelated to either the productivity of its workforce or the “profitability” of the USPS. While the USPS can negotiate some of the cost sharing of these benefits, the provision of these benefits is governed by statute.<sup>175</sup> The USPS has over \$126 billion in unfunded worker liabilities stemming from its pensions (\$43.5

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<sup>175</sup> 39 U.S.C. § 1005(c), (d), and (f).

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billion), retiree health benefits (\$66.5 billion), and the federal workers' compensation program (\$16.4 billion).<sup>176</sup>

### *Pensions*

As noted above, Postal workers, like most federal civil service employees, participate in the Civil Service Retirement System (CSRS) or the Federal Employees Retirement System (FERS). The combined USPS unfunded liability for these programs was \$43.5 billion as of the end of FY 2018.<sup>177</sup> The USPS, like federal agencies, cannot change the structure of these benefits. Although the 1974 Employee Retirement Income Security Act prevents private companies from taking away pension benefits that workers have already earned, it allows them to end all accruals going forward, even for current employees. There is an ongoing trend for private companies to either end future accruals or terminate their defined benefit plans altogether to reduce the amount of long-term liabilities on their books.

### *Retiree Health Benefits*

The Office of Personnel Management (OPM) operates the Federal Employees Health Benefits (FEHB) Program, which provides health benefits for retired federal employees, including retired USPS employees. As a general rule, OPM pays for part of these retiree health benefits, rather than the federal agency that previously employed the retiree. These payments are made from an appropriation to OPM, meaning that the general taxpayer funds the federal government's FEHB contribution.<sup>178</sup> The exception to this funding rule is for the retiree health benefits of retired USPS employees. For years, the USPS has been the one civilian entity that is statutorily required to pay OPM directly for the cost of its retiree health benefits.<sup>179</sup>

In managing the government wide program, OPM pays only the current year premiums for retiree health benefits, paying on a pay-as-you-go basis. OPM does not make contributions into a fund for future federal employee retiree health benefits, meaning that the future liability for federal employee health benefits is not pre-funded. An exception to this funding practice exists for the USPS. Since passage of PAEA, the USPS has been statutorily required to make annual contributions into the Postal Service Retiree Health Benefits Fund (PSRHBF), which is administered by OPM, to cover the liability for future USPS retiree health benefits.<sup>180</sup> Based on the balance in the PSRHBF at the end of FY 2017, this future liability is only 44 percent funded.

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<sup>176</sup> United States Postal Service, *Form 10-K reports from 2007-2018*, available at: <http://about.usps.com/who-we-are/financials/>.

<sup>177</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2018*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2018.pdf>.

<sup>178</sup> The law provides that the federal government's contribution may not exceed 75 percent of the "subscription charge." 5 U.S.C. § 8906(b)(2). This means that most federal annuitants pay at least 25 percent of the cost of their health insurance.

<sup>179</sup> See 5 U.S.C. § 8906(g).

<sup>180</sup> 5 U.S.C. § 8909a.

Although the USPS made \$21 billion in contributions to the PSRHBF for its future retiree health benefits from 2007 through 2010, as required by law, the USPS has failed to make its required annual contributions since that time. The USPS has used nonpayment of its statutorily required contributions to the PSRHBF as its primary means to maintain sufficient cash balances needed to continue day-to-day postal operations. As a result of the missed contributions, the USPS maintains a payable and OPM, as administrator of the PSRHBF, has a corresponding receivable of \$43 billion for unfunded USPS retiree health benefits.

Congress required the USPS, rather than the general taxpayer, to fund the retiree health benefits of its employees as part of a mandate for postal self-sustainability under which the USPS functions as an off-budget entity. The USPS is exempt from any general limitations on expenditures imposed on the United States Government. It is permanently allowed to spend its revenues without fiscal year limitation and it maintains limited borrowing authority.<sup>181</sup>

### *Federal Workers' Compensation Program*

The USPS participates in the federal workers' compensation program administered by the Department of Labor (DOL).<sup>182</sup> When an injured employee receives a favorable ruling for disability claims, the USPS lists the discounted value of all future payments as a liability on its books. Most payments are made in installments, and as a result, the liability remains on the USPS books until the payments stop. As of the end of FY 2018, the total liability for disability claims amounted to \$16 billion.

## C. Findings and Recommendations

### Operations

***USPS's dual-labor model – combining private sector collective bargaining law with government employee compensation law – creates unsustainable labor costs. USPS employee rights should be more closely aligned with other federal employee rights by eliminating collective bargaining over compensation.***

The Task Force recommends that the Federal Service Labor-Management Relations Act be amended to apply to the USPS and its employees, and remove USPS compensation from collective bargaining. Doing so would enable the USPS to address the costs and complications with its current labor system, and allow for better workforce planning and cost control within its rapidly evolving business model. In the meantime, the USPS should take immediate action where current statutory authority exists, including, but not limited to,

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<sup>181</sup> 39 U.S.C. §§ 2003(a), 2005, and 2011(a)(2).

<sup>182</sup> 39 U.S.C. § 1005(c); and 5 U.S.C. § 8101 et seq.

aligning collective bargaining agreements with these principles. USPS employees should not be afforded protections and rights not enjoyed by other federal employees.

***USPS employee wages should be reformed in a manner consistent with proposed reforms pertaining to the broader federal workforce outlined in the President's Management Agenda.***

Although the USPS has reduced the total number of its employees since 2000, the USPS's labor costs continue to represent a significantly higher proportion of total operating costs when compared to its private sector competitors. USPS employees enjoy a pay and benefits premium over their private sector counterparts, although the size of this premium is likely falling. Consistent with the President's Management Agenda to modernize the government workforce and better align the compensation of federal employees with the labor market, the Task Force recommends that the USPS more closely align compensation for both its career and non-career workers with peers in the broader labor market.

***The USPS should explore new business opportunities that allow it to extract value from its existing assets and business lines.***

In addition to franchising the mailbox, the USPS should explore supplying services for Federal, State, and local government entities that have substantial scale, would generate revenue, and would not present a balance sheet risk to the USPS. For example, the USPS could expand government services by processing certain licenses, such as those for hunting and fishing. The USPS could also capture additional value from its existing retail offices by converting post offices into contract post offices or by co-locating with or renting space to complementary retail establishments.

Given the USPS's narrow expertise and capital limitations, expanding into sectors where the USPS does not have a comparative advantage or where balance sheet risk might arise, such as postal banking, should not be pursued.

### Governance and Regulation

***The USPS suffers from a lack of institutional governance, both in authority and in practice, and there is an immediate need for the U.S. Senate to confirm Governors.***

The Governors have the authority to select the Postmaster General and Inspector General, as well as to approve and oversee the practices and policies of the USPS. However, their ability to direct USPS activities is limited by law and subject to oversight by other authorities such as Congress, the PRC, arbitrators, and GAO.<sup>183</sup>

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<sup>183</sup> United States Postal Service, Office of Inspector General, *Governance of the U.S. Postal Service*, RARC-WP-17-002, (November 10, 2016), available at: <https://www.uspsoig.gov/sites/default/files/document-library-files/2016/RARC-WP-17-002.pdf>.

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Further, there are only two Governors confirmed, severely limiting the Board of Governor's ability to effectively direct and control USPS expenditures and review the practices and policies of the USPS. There is an immediate need for the U.S. Senate to confirm additional Governors. The Board of Governors should move to create a new policy mandate that resets the USPS's organizational direction and develops financial targets that move the USPS toward the achievement of a sustainable business model. Governance should be strengthened with expanded Board controls and increased accountability. Moreover, if the USPS is unable to achieve a sustainable business model and satisfy its financial commitments to other federal agencies, the PRC should be given stronger regulatory authority to take necessary revenue and expense measures.

***The Postal Regulatory Commission authorities are limited, leaving gaps in the supervision of significant USPS monopoly and competitive activities.***

The PRC exercises regulatory oversight of the USPS's price changes, cost allocations, and certain operations. It does not have regulatory authority over the full range of USPS operations. While the PRC can recommend changes to service standards, it cannot direct USPS to make these changes; however, the PRC can take action to ensure that the USPS complies with existing service standards following the receipt of a valid complaint. The PRC generally cannot force the USPS to make major changes in its operations or to make capital investments to meet a service standard.<sup>184</sup> As a result, many aspects of the USPS's operations lack independent regulatory oversight.

The Task Force recommends strengthening the regulatory oversight role of the PRC, providing them with expanded controls, imposing increased accountability on the USPS.

### Benefits

***USPS represents approximately 46 percent of the federal government's workers compensation cost.<sup>185</sup> The Federal Employees Compensation Act should be reformed as proposed in the President's FY 2019 Budget.***

Postal workers are more likely to be injured on-the-job due to the physical and outdoor nature of their work, as contrasted with the sedentary office work of most other federal employees. The Task Force recommends pursuing reforms to the Federal Employees

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<sup>184</sup> PRC has robust enforcement authority. It can order fines in cases of deliberate noncompliance; it has subpoena authority; and it can bring suit in federal district court to enforce and enjoin and restrain the USPS from violating its orders. 39 U.S.C. §§ 3662 and 3664.

<sup>185</sup> United States Department of Labor, Office of Workers' Compensation Programs, *Annual Report to the Congress, Fiscal Years 2013, 2014 and 2015*, (2017), available at <https://www.dol.gov/owcp/AnnualReportOWCPFY201320142015.pdf>.



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Compensation Act, that were included in the President's FY 2019 Budget with an estimated net savings of \$117 million over ten years.<sup>186</sup>

***While the USPS pension liabilities are better funded than those of the rest of the federal government, they would benefit from further reform.***

USPS has funded 87 percent of its CSRS liabilities and 88 percent of its FERS liabilities, compared to 14 percent and 83 percent, respectively, for the federal government.<sup>187,188</sup> Notwithstanding USPS's positive funded percentages, reforms are needed for the Federal Employee Retirement System, in which USPS employees participate, to increase employee contributions and to convert, where possible, to a defined contribution system. These would require legislative changes.

***The USPS, not the taxpayer, is responsible for funding the USPS's retiree health costs and the Task Force believes that it should remain this way.***

As noted above, Congress required the USPS, rather than the general taxpayer, to fund the retiree health benefits of its employees as part of a mandate for postal self-sustainability under which the USPS functions as an off-budget entity. The Task Force does not believe that this general policy should change or that the liability for USPS retiree health benefits should be shifted to the general taxpayer, either directly or through future federal appropriations.

However, as a further principle of reform, the Task Force believes that the obligation, including the \$43 billion in pre-funding payments that the USPS failed to pay into the PSRHB and the unfunded actuarial liability, must be restructured with the payments re-amortized with a new actuarial calculation based on the population of employees at or near retirement age.

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<sup>186</sup> Office of Management and Budget, *Budget of the U.S. Government: 2019*, available at: <https://www.whitehouse.gov/wp-content/uploads/2018/02/msar-fy2019.pdf>.

<sup>187</sup> United States Postal Service, *Form 10-K for the Fiscal Year Ended September 30, 2017*, available at: <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

<sup>188</sup> United States Office of Personnel Management, *Civil Service Retirement and Disability Fund Annual Report, Fiscal Year Ended September 30, 2017*, available at: <https://www.opm.gov/about-us/budget-performance/other-reports/fy-2017-csrd-f-annual-report.pdf>.

## Appendix A – Task Force Recommendations

| Recommendation   | Policy Action  |
|--|----------------|
| <b>Universal Service Obligation (USO)</b>  |                |
| <i>Definition</i>  |                |
| Clearly define the USO. Provide a targeted definition of minimum, essential postal services, that due to specific social and economic needs have a basis for government protection.                          | Administrative |
| <i>Geographic Scope</i>  |                |
| Keep current practice, which designates that the USO includes all addresses in the country covering “the United States, its territories and possessions,” <sup>189</sup> irrespective of population density. | Administrative |
| <i>Number and Density of Post Offices and Collection Boxes</i>   |                |
| Establish a rule that specifies that access to the postal system must only be sufficient to implement defined USO standards for delivery.  | Administrative |
| <i>Delivery Frequency</i>  |                |
| Provide greater flexibility to determine mail and package delivery frequency.  | Legislative    |
| <i>Mode of Delivery</i>  |                |
| Maintain current discretion to determine mode of delivery consistent with a financially sustainable business model.  | Administrative |
| <i>Processing Standards</i>  |                |
| Keep current practices, which allow the USPS to manage processing standards.   | Administrative |
| <i>USO Funding</i>   |                |
| Review and determine if income generated by activities defined to be outside of the USO could be optimized to cover the costs of funding the USO.  | Administrative |

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<sup>189</sup> 39 U.S.C. § 403. Section 403(a) provides that the USPS “shall serve as nearly as practicable the entire population of the United States.”

## United States Postal Service: A Sustainable Path Forward

| Recommendation  | Policy Action  |
|---|----------------|
| <b>Mail and Package Markets</b>   |                |
| <i>Business Model</i>   |                |
| Develop a new model that can be used to both set rates and control costs to achieve sustainability.   | Administrative |
| Require price increases, reduce service costs, or exit the business for any mail products that are not deemed an essential service and do not cover their direct costs.                           | Administrative |
| <i>Product Classes</i>  |                |
| Redefine mail classes by creating products defined by the type of sender and the declared purpose of the mail item.   | Administrative |
| Change USPS systems in order to track the purposes and uses of mail, to allow for better cost allocation, targeted pricing, and more business intelligence.                                       | Administrative |
| <i>Strategic Options</i>  |                |
| Evaluate areas of USPS operations where the USPS could expand third party relationships in order to provide services in a more cost efficient manner (e.g., mid-stream logistics and processing). | Administrative |
| As a means of generating more income, the mailbox monopoly could be monetized.  | Administrative |
| Price competitive products in a manner that maximizes revenues and generates income that can be used to fund capital expenditures and long-term liabilities.                                      | Administrative |
| <i>Costing Options</i>  |                |
| Develop a new cost allocation model to establish full price transparency and fully distribute costs.  | Administrative |
| Establish a separate balance sheet for packages to help prevent cross-subsidization between the mail and package business units.  | Administrative |

## United States Postal Service: A Sustainable Path Forward

| Recommendation   | Policy Action |
|--|---------------|
| <b>Operating Model</b>   |               |
| <i>Operations</i>  |               |
| Align USPS employee rights with other federal employee rights by eliminating collective bargaining over compensation for USPS employees.   | Legislative   |
| Pursue reforms to USPS employee wages consistent with those proposed for the broader federal workforce in the President’s Management Agenda.   | Legislative   |
| Explore and implement new business lines that generate revenue, and that present no balance sheet risk to the USPS.  | Legislative   |
| <i>Governance and Oversight</i>  |               |
| Strengthen the governance and regulatory oversight of USPS. This could be achieved through reforming, but maintaining, the existing institutional structures or by changing the institutional structures, which would require legislation.   | Legislative   |
| Institute a new policy mandate for management that sets organizational direction and financial targets, which align with a sustainable business model and establish an enforcement mechanism if the existing Board is unable to meet these targets.  | Legislative   |
| Strengthen the regulatory oversight role of the PRC, providing the PRC with expanded controls, imposing increased accountability on the USPS.  | Legislative   |
| <i>Benefits</i>  |               |
| Pursue reforms proposed to the Federal Employees Compensation Act that are included in the President’s FY 2019 Budget.   | Legislative   |
| Pursue reform of the Federal Employee Retirement System that would increase employee contributions and move toward a defined contribution system.  | Legislative   |
| Maintain but restructure the retiree health benefits liability, including the \$43 billion in pre-funding payments that the USPS failed to pay into the Postal Service Retiree Health Benefits Fund and the unfunded actuarial liability, with the total liability re-amortized with a new actuarial calculation based on the population of employees at or near retirement age. | Legislative   |

## Appendix B – Participants List

### USPS Employee Organizations

American Postal Workers Union  
National Active and Retired Federal Employees Association  
National Association of Letter Carriers  
National Association of Postal Supervisors  
National Postal Mail Handlers Union  
National Rural Letter Carriers' Association  
United Postmasters of America

### Associations

Association for Postal Commerce  
Association for Print Technologies  
Association of Magazine Mailers  
Alliance of Nonprofit Mailers  
Association of United States Postal Lessors  
American Forest and Paper Association  
American Bankers Association  
Coalition for a 21<sup>st</sup> Century Postal Service  
Data & Marketing Association  
Data-Mail Inc.  
Envelope Manufacturers Association  
Greeting Card Association  
International Mailers Advisory Group  
IWCO Direct  
Major Mailers Association  
Meredith Corporation  
National Association of Presort Mailers  
National Newspaper Association  
Parcel Shippers Association  
Printing Industries of America  
Publishers Clearinghouse

### Private Sector

Amazon  
DHL  
Express Scripts  
eBay  
FedEx  
Hallmark  
International Paper  
Quad Graphics  
Pitney Bowes  
RR Donnelley  
UPS

### Consumer Groups

Consumer Action  
Citizens Against Government Waste

### State, Local, and Tribal

National Association of Counties  
National Congress of American Indians  
National Governor's Association  
National League of Cities



## Acronyms and Abbreviations

| Acronyms and Abbreviations | Terms  |
|----------------------------|--|
| B2B                        | Business-to-Business   |
| B2C                        | Business-to-Consumer   |
| COLA                       | Cost of Living Allowance   |
| CPI-U                      | Consumer Price Index for all Urban Consumers   |
| CSRS                       | Civil Service Retirement System  |
| Department                 | Post Office Department   |
| FEHB                       | Federal Employees Health Benefits Program  |
| FERS                       | Federal Employees Retirement System  |
| GAO                        | U.S. Government Accountability Office  |
| Governors                  | USPS Board of Governors  |
| MSP                        | Mail Service Providers   |
| NSA                        | Negotiated Service Agreement   |
| OIG                        | Office of Inspector General  |
| OMB                        | Office of Management and Budget  |
| OPM                        | Office of Personnel Management   |
| PAEA                       | Postal Accountability and Enhancement Act of 2006  |
| PRA                        | Postal Reorganization Act  |
| PRC                        | Postal Regulatory Commission   |
| PSRHBF                     | Postal Service Retiree Health Benefits Fund  |
| UPU                        | Universal Postal Union   |
| USO                        | Universal Service Obligation   |
| USPS                       | United States Postal Service   |
| Task Force                 | Secretary of the Treasury, Director of the Office of Management and Budget, Director of the Office of Personnel Management |
| Treasury                   | U.S. Department of the Treasury  |

