



ASSESSMENT OF U.S. POSTAL SERVICE FUTURE BUSINESS MODEL

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Preface

The Postal Act of 2006 requires the Government Accountability Office (GAO) to complete a study on the future business model of the Postal Service by 2011; however, due to the Postal Service's precarious financial situation, GAO is planning to produce its report in the spring of 2010. The requirements of the study are fully outlined in section 710 of the Act.¹ In general, the statute requires GAO to recommend a business model that will ensure the public continues to receive affordable universal postal service. Included with its report, GAO must recommend how to minimize any negative effects the business model could be expected to have on postal stakeholders. GAO is also required to consult with the Postal Service and others as part of this process. This paper is just one part of that consultation process, and the Postal Service intends it to serve as a starting point for an ongoing discussion. While the law does not specify a time horizon for the analysis of potential changes to future business model, the Postal Service believes that this analysis needs to focus beyond the current financial crisis, and instead be comprehensive and address how best to both achieve near-term financial stability and serve the country for the next 10 to 20 years.

¹ P.L. 109-43

Executive Summary

For 36 years, the Postal Service's business model, established by the Postal Reorganization Act of 1970 (PRA), worked very well for customers, employees, and the nation. The Postal Service was able to charge affordable prices and use the revenues from those prices to provide mail service to all areas of the country, charging the same prices regardless of cost of delivery. It was able to cut costs, improve service, provide innovative workshare options, and continually improve productivity.

While the intent of the Postal Accountability and Enhancement Act of 2006 (Postal Act of 2006) was to give the Postal Service more flexibility to manage its products, it put the bulk of the Postal Service's revenue generating products under a stringent price cap and gave the Postal Service no additional ability to control its costs. An underlying presumption of the Postal Act of 2006 was that mail volume would continue to grow. That premise has proven false. The combination of the recession and electronic diversion has led to a significant decline in total volume, including a substantial decline in First-Class Mail, the highest-contribution product. The Postal Service has little ability to offset revenue declines; the law restricts it to only providing postal products and limits how it can price and manage these postal products.

In addition, the Postal Service has substantial fixed costs, and delivery network expansion continuously drives costs upward. The universal service obligation requires the Postal Service to maintain portions of its transportation and retail networks regardless of mail volume. The Postal Service is a labor-intensive organization; approximately 79 percent of its total costs are the wages and benefits of its employees. While the Postal Service has been aggressively moving toward reducing its workforce, the Postal Service's management of the actual cost of labor is limited due to collective bargaining and certain requirements under the law. The Postal Service is also burdened by the requirement to aggressively prefund its retiree health benefit obligation for future retirees. Without this requirement, the Postal Service would have earned an overall profit of approximately \$4 billion over the 2007-2009 timeframe. Even in those areas where the Postal Service theoretically has the ability to control its costs, it often faces political resistance when it attempts to close or consolidate facilities. This means that costs cannot decrease as rapidly as volume and revenue decline. Due to this combination of factors, the Postal Service is no longer able to generate enough revenue to cover costs.

The Postal Service cannot continue to provide affordable, universal service to all areas of the country while maintaining mandated inflation-based prices without an increased ability to generate revenue and control costs. Therefore, bold changes to the business model are needed. All options – even those that have been dismissed in the past – need to be considered as part of the national discussion.

In order to choose the best business model for the Postal Service, it is important first to establish the future role of the Postal Service and the mission the nation needs it to fill. Over the years, the Postal Service has played many roles. By statute, the mission of the Postal Service is to “bind the nation together.”² This is typically thought of as providing hard copy delivery. But, historically, the mission of the Postal Service has been broader, including educating and informing the public, enabling commerce, and representing the federal government in local communities. The key to determining the appropriate future business model of the Postal Service is clarifying its role. What future role does the nation, the market, and postal customers need the Postal Service to play?

While the mailing needs of the country are changing, there is still a need for affordable, universal postal services and trusted, secure mail delivery. The Postal Service should maintain its responsibility for supplying affordable, universal service. To fulfill this role, it will need additional flexibilities to manage its costs and increase its revenues, and fulfill its mission as the Postal Reorganization Act of 1970 intended. This paper outlines some of the potential business model options, including considerations and implications.

The need to address this matter is urgent. The Postal Service lost over \$12 billion in the last three years and expects to lose almost \$8 billion in 2010. The Postal Service is becoming financially unstable and urgent action is needed to ensure that mail continues to be delivered.

² 39 USC Sec 101 (a).

Future Business Model of the Postal Service

A. Introduction

The United States Postal Service is facing the most urgent financial challenge in its history. Protecting the viability of the nation's postal system is a complex and difficult task that has no simple solution. The Postal Accountability and Enhancement Act of 2006 (hereafter referred to as the Postal Act of 2006) revised the break-even regulatory model of the Postal Reorganization Act of 1970 (PRA) in favor of a profit and loss model. An underlying presumption of the Postal Act of 2006 was that mail volume would continue to grow. However, falling mail volumes due to the recession and electronic diversion, combined with the additional statutory burdens that are discussed in greater detail later in this paper, make it evident that the Postal Service's existing business model does not provide the flexibility needed to meet the new market realities. The tools available to the Postal Service are insufficient to respond to the combined effects of the economic recession, the diversion of mail to electronic alternatives, and the statutory requirement that the Postal Service pre-pay between \$5.4 billion and \$5.8 billion every year through 2017 to the future retiree health benefits fund.

Fundamental restructuring of the Postal Service's business and regulatory framework is essential. The Government Accountability Office (GAO) has placed the Postal Service on its high-risk list this year, stating that broad restructuring is urgently needed to counter rapidly declining mail volumes. The GAO also said that expenses must be cut quickly to offset volume and revenue declines, and that the Postal Service should consolidate operations, close unneeded facilities, and reduce the size of its workforce to reflect trends in mail use. These actions are necessary in addition to Postal Service efforts that removed \$2 billion in costs in 2008 and over \$6 billion in costs in 2009.³

The topic of a new business model for the Postal Service is not new; it has been discussed and debated for years.⁴ In 2003, the President's Commission on the United States Postal Service issued a report suggesting various changes to the Postal Service's

³ All references to a specific year or "the year" refer to the Postal Service fiscal year ending September 30. However, specific month and year references pertain to the calendar date.

⁴ Appendix A contains a list of various documents that relate to the future business model of the Postal Service.

business model.⁵ It should be noted that, while some of the report's recommendations were incorporated into the Postal Act of 2006, none that would increase the ability to manage costs were included.

There has also been debate about whether the Postal Service benefits from its unique status as a self-sufficient government agency. In its 2007 report, the Federal Trade Commission found that the Postal Service has a net comparative disadvantage versus private carriers.⁶

During the preparation of this report, the Postal Service examined lessons learned from other industries and other posts. This information is discussed in the relevant sections of this report, and a more detailed discussion is included in Appendix B.

B. Business Model Does Not Provide Adequate Revenues to Cover Costs

The Postal Service is among the few federal agencies required to be self-funded; that is, its revenues from mailing and shipping services must cover its costs. The current business model of the Postal Service relies on the premise that revenues from postal products and services will be sufficient to cover the cost of providing mail service to the constantly expanding delivery network. Unfortunately that premise does not hold in times of rapidly declining volumes. The Postal Service has substantial fixed costs given its extensive processing, retail, and delivery networks. This means that, in general, costs do not grow as rapidly as corresponding increases in mail volume and revenue. Conversely, as volume and revenue decline, costs do not decrease as rapidly. Therefore it is difficult for the Postal Service to earn enough revenue to cover costs in times of declining volumes with its current business model. And that is the situation in which the Postal Service finds itself in now and in the likely future.

1. Revenue Generation

The combination of electronic diversion and the recession has led to an unprecedented level of volume decline and a resulting revenue decline. The Postal Service is constrained in its ability to generate new revenue. Unlike its competitors, other private sector businesses, and many foreign posts, it is not allowed to diversify and

⁵ Report of the President's Commission on the USPS: Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service. 2003. <http://www.treas.gov/offices/domestic-finance/usps/pdf/freport.pdf>

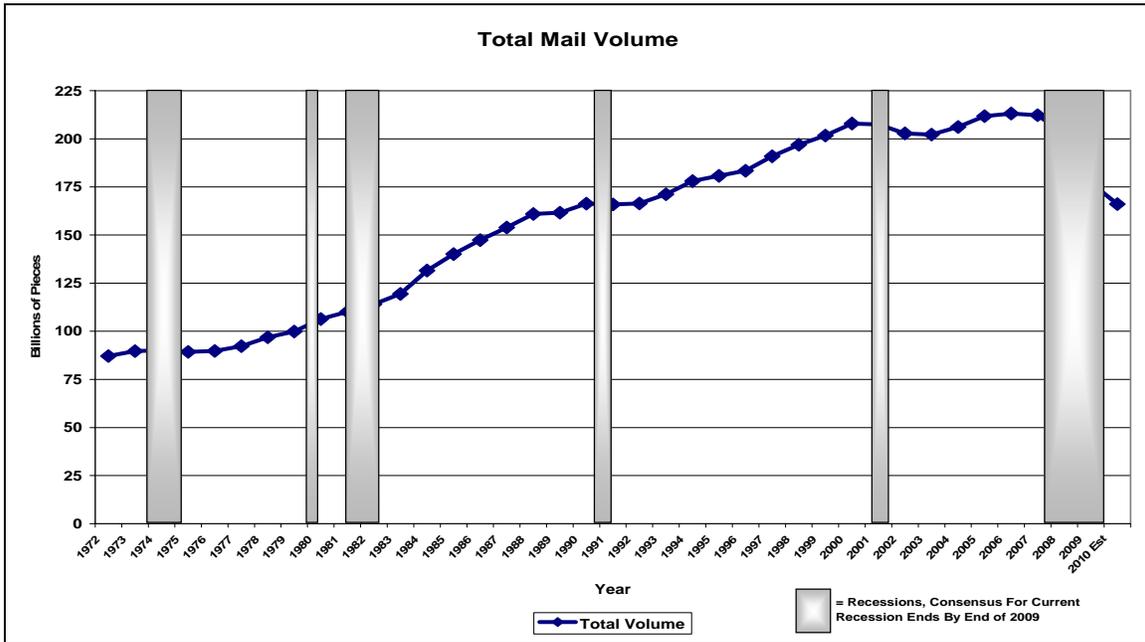
⁶ Federal Trade Commission report: Accounting for Laws That Apply Differently to the United States Postal Service and its Private Competitors, Dec. 2007. <http://www.ftc.gov/os/2008/01/080116postal.pdf>

instead is limited to offer only “postal” products. And it is difficult for the Postal Service to effectively leverage pricing for existing postal products due legislative and regulatory constraints, including a price cap on 90 percent of its revenue.

a. Mail Volume Is in Decline

As seen in Table B-1 below, for the past three decades, the Postal Service enjoyed rapid growth in mail volume. Volume more than doubled, from about 87 billion pieces in 1971 to 207 billion pieces in 2001. Economic and population growth, rapid increases in financial statement and transaction mail, and an explosion in direct marketing and saturation advertising generated new mail volume year after year. While electronic diversion and recessions did periodically cause some negative effects, they did not cause material or permanent declines.

Table B - 1



The impact of the current recession is much worse. The Postal Service closed 2009 with volume down sharply, to 177 billion pieces, a decline of 17 percent between 2006 and 2009. Additional volume decline of 10 billion pieces is expected in 2010. The Postal Service is losing the past 15 years of growth and is left to struggle with a less profitable mix of volume and additional costs.

Looking beyond 2010, it is likely that economic recovery will cause Standard Mail to bounce back slightly for a year or two. However, most positive mail volume drivers have either run their course or are expected to have moderate impact going forward.

Negative volume drivers, like electronic diversion and the green movement, are expected to continue.

b. Remaining Mail Volume Is More Volatile and Subject to Economic Conditions

To make matters worse, First-Class Mail has dropped from about 54 percent to 47 percent of total mail volume over the last 15 years. This trend harms postal finances in two ways. First-Class Mail is the highest contributor to institutional costs. It takes almost three pieces of Standard Mail (advertising mail) to make up for the lost contribution of one piece of First-Class Mail. In addition, as Standard Mail grows to be a larger percentage of total mail volume, volume and revenue become more susceptible to downturns in the economy. This is compounded because almost 10 percent of First-Class Mail is now advertising mail. Actual correspondence, both business and personal, is now only about 10 percent of the mail volume. Commercial customers currently generate 80 percent of postal revenue, generating mail that is primarily used to attract or maintain business and is more volatile and subject to economic conditions.

c. Revenue Diversification Is Not Allowed

In a 2009 report, Accenture found that revenue diversification was one of the key components to successful postal organizations.⁷ Unlike most private sectors businesses and most other posts, the Postal Service is unable to diversify its sources of revenue to cushion its finances from market changes. The Postal Act of 2006 limits the Postal Service to offering postal services, except for a limited number of nonpostal services that were offered prior to January 1, 2006, and grandfathered in by the Postal Regulatory Commission (PRC).⁸ Since the majority of the Postal Service's revenue generation is dependent on mail volume, this lack of revenue diversification becomes more problematic as mail volumes continue to decline.

As Table B-2 shows, many foreign posts generate substantial revenue from non-mail services. There are numerous examples. Deutsche Post DHL (Germany) offers an array of nonpostal services including logistics and financial services.⁹ France's La

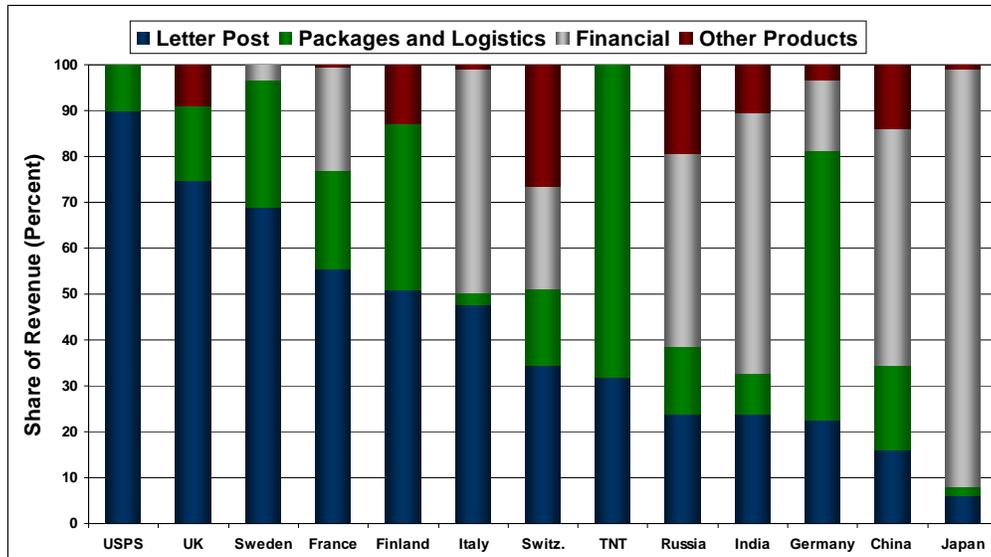
⁷ Accenture. Achieving High Performance in the Postal Industry. Accenture Research and Insights. 2009.

⁸ "Postal services" are defined by the law as the delivery of letters, printed matter, or mailable packages, including acceptance, collection, sorting, transportation, or other functions ancillary thereto (120 STAT 3199).

⁹ See Appendix B for a more detailed discussion.

Poste and Australia Post are allowed to provide sales of telecommunication products, including mobile phone recharge cards.

Table B-2



d. Limitations to Managing Postal Products

The Postal Service is not only limited to offering postal products, it is also limited in how it can price and manage its postal products. Other industries are able to capture changes in market demand by completely revamping how they offer their products and services. However, it is difficult for the Postal Service to move away from its legacy legislative and regulated classification structure, which narrowly define a “product” and a “class.” These product groupings define pricing restrictions and reporting requirements and can greatly restrain the Postal Service’s ability to successfully manage its products in response to changing market demands. For example, the PRC is currently evaluating the arguments that workshare discounts should be equal to 100 percent of cost savings, and that the definition of workshare be very broad. A strict interpretation of this proposal would result in the Postal Service having the ability to set only the First-Class single-piece rate, which is constrained by the requirement to be a whole integer; the remaining First-Class Mail rates would simply be a calculation from the single-piece rate. This would severely limit the Postal Service’s ability to price effectively.

In addition, the Postal Service is required by law to provide reduced rates for preferred mail products,¹⁰ provide one class that is sealed against inspection at a

¹⁰ 39 USC 3626.

uniform rate¹¹, and provide a uniform rate for books, films and other materials.¹² It is also constrained by the price cap, which limits the Postal Service to raising the average price of each market dominant class by no more than the change in the Consumer Price Index (CPI). While it makes financial sense for the Postal Service to limit price increases, in order to survive the Postal Service needs the flexibility to adjust products and prices to meet changing market demands. As volume declines, the Postal Service would benefit from being able to introduce more value-based pricing and change its product structure, such as simplifying product offering for consumers. But it will be difficult to move to a value-based structure due to the limitations and special interests mentioned above.

2. Current Cost Structure

In the past two years, the Postal Service has made substantial cost reductions — amounting to over \$8 billion — while improving service. However, many costs are difficult for the Postal Service to control, especially in the short term. Costs are driven by the requirement to provide affordable universal service to all addresses in the United States. Costs are continuously driven upward by the need to provide six-day a week delivery to a constantly expanding delivery network. Each year, as the number of households grows, the Postal Service adds 1 to 2 million new deliveries to its network. The universal service obligation requires the Postal Service to maintain portions of its transportation, and retail networks, even when volume falls.

a. Network Costs

The Postal Service's retail, delivery, mail processing and related transportation networks are large and complex and have evolved over time. To reduce costs, the Postal Service needs to realign its networks to meet changing customer behavior. However, the Postal Service faces both legal and political resistance in making network changes.

1) Mail Processing and Transportation

The Postal Service mail processing and related transportation networks are the product of an evolutionary process that began more than 230 years ago. Mail was carried between postal facilities first by horseback, then by stagecoach, followed by rail,

¹¹ 39 USC 404c.

¹² 39 USC 3683.

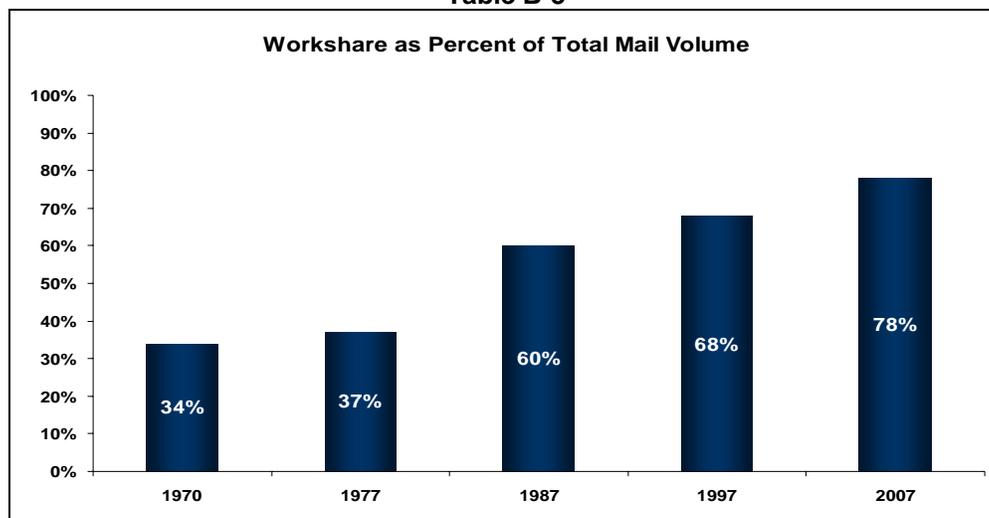
highway and air transportation. In the early days of the system, when mail volume was low, mail was sorted at each individual Post Office. As volume grew, and the distance mail traveled increased, mail sorting was moved to more centralized locations. This network of centralized processing locations has evolved over time – from General Post Offices to State Distribution Centers to Area Distribution Centers to Processing Distribution Centers – changing in response to shifting technology and mail volumes. The two biggest causes of shifts in processing needs were new sorting technology and the introduction of workshare incentives.

Investing in automated processing allowed the replacement of labor with capital. The average cost of sorting a flat by automation is approximately one-fourth the cost of manually sorting a flat. The average cost of sorting a letter by automation is approximately one-fourteenth the cost of manual sortation. Over the last 10 years, the Postal Service has successfully moved the majority of its letter mail to automation; currently over 90 percent of letter volume sorted by machine from deposit to delivery. With the deployment of the Flats Sequencing System (FSS), the Postal Service is moving towards automating flat mail to the same degree. Combined with automated letter processing, FSS will virtually eliminate the need for carriers to sort any mail before delivery.

Worksharing – partnering with customers to help prepare the mail – also allows the Postal Service to better manage its costs. By law, workshare activities include presorting, prebarcoding, and handling or transportation of mail.¹³ Automation price incentives and requirements – for example, applying barcodes and printing quality addresses – increase sorting productivity and reduce the odds that mail pieces will be sorted manually. Presorting encourages customers, through price discounts, to perform mail preparation, often done prior to production instead of handling physical mailpieces. Destination entry prices allow mailers to enter their mail at a facility closer to delivery, saving postal processing and transportation costs. As shown in Table B-3, workshare mail of one kind or another now makes up a significant portion of the mail, almost 80 percent.

¹³ 39 USC 3622e.

Table B-3



The combination of declining volume, worksharing, and advances in automation has reduced the need for processing facilities and transportation. In response to these changes and despite political opposition in a number of instances, the Postal Service has aggressively moved to consolidate facilities, reducing the number of total processing facilities by 22 percent over the last 10 years. This reduction was achieved despite mail volume more than doubling over the same time period. The decline in the need for facilities and the substitution of capital for labor translates into a 36 percent reduction in mail processing workhours.

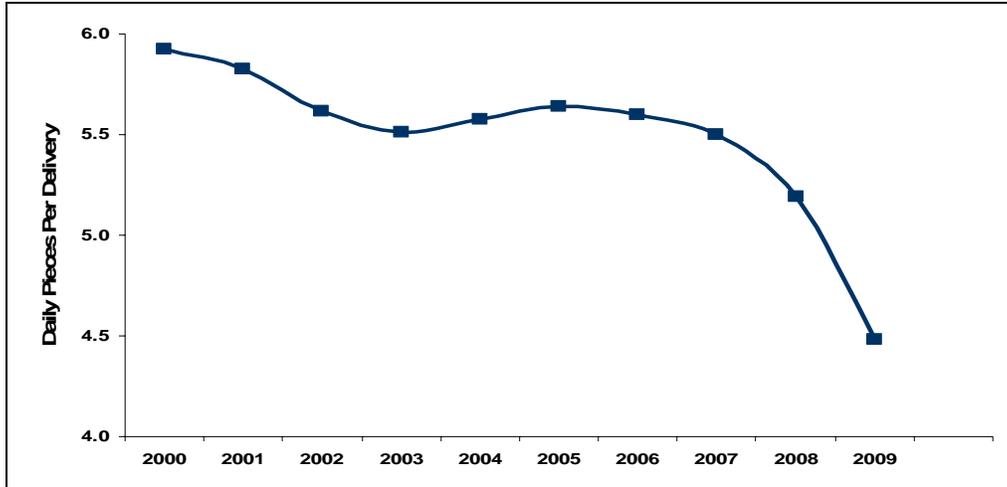
While the Postal Service has made great strides in consolidating facilities, it must further reduce its mail processing networks to align costs with dramatically reduced volume. In many locations automated equipment is no longer processing intended volumes, resulting in declining productivity and a diminished return on investment. Even after the economy recovers, mail volume is not expected to return to pre-recession levels.

2) Delivery Network

The delivery network continues to expand, at the rate of 1 to 2 percent more delivery points a year. Decline in mail volume and continuing increases in the number of delivery points reduce the pieces-per-delivery point. This has little impact on costs since delivery costs, by their very nature, are highly fixed. Regardless of the amount of mail to be delivered, the carrier must traverse his entire route every delivery day. However, a decrease in the daily pieces-per-delivery reduces the *revenue*-per-delivery point –

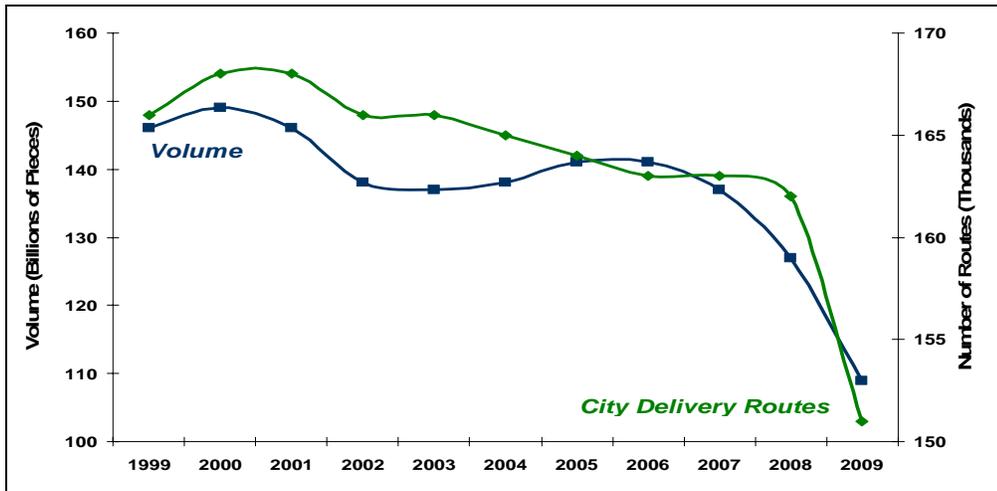
meaning that less revenue is available to finance an expanding network of addresses. Table B-4 shows that the number of daily pieces-per-delivery point has dramatically declined over the past decade.

Table B-4



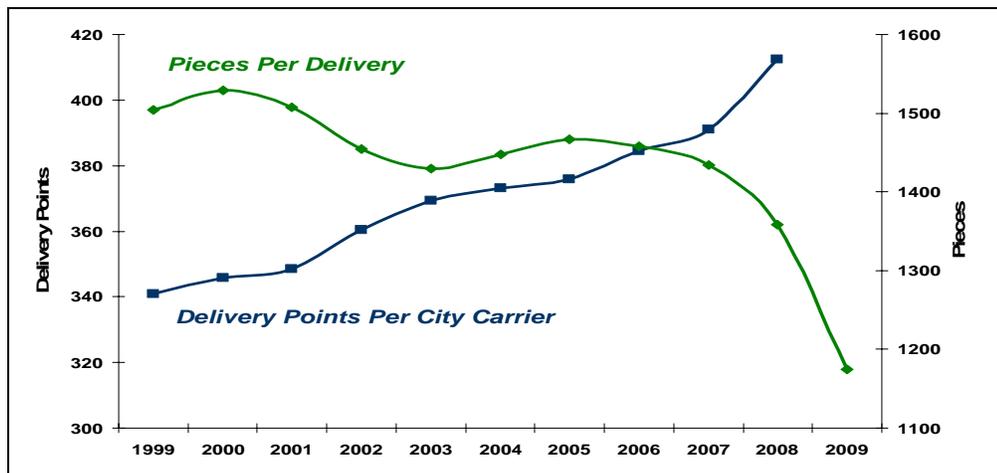
The Postal Service has been using all the tools within its control to reduce delivery costs. It has increased efficiency by automating the sortation of letter mail into the sequence in which carriers deliver. The Flat Sequencing System (FSS) will further this efficiency by sorting flats into the same sequence. Delivery point sequencing reduces the time carriers need to prepare mail for delivery. This leaves carriers with more time for street delivery, enabling them to cover longer routes and more delivery points. Up to a point, this has made it possible for the Postal Service to handle additional delivery points while reducing the total number of carrier routes and carriers. To continue to bring down delivery costs, the Postal Service is aggressively evaluating delivery routes in order to consolidate them where possible. As seen in Table B-5, the number of delivery routes has been considerably reduced delivery routes in the last 10 years.

Table B-5



In fact, 2,500 city delivery routes have been consolidated using an interim alternate route adjustment process negotiated with the National Association of Letter Carriers (NALC). City carriers now service 21 percent more stops than in 1999 and 8 percent more than in 2007 when the volume decline accelerated.

Table B-6



Rural delivery work hours have been reduced despite the addition of an estimated 450,000 delivery points. The 2009 National Rural Mail Count resulted in an average decrease of 121 minutes per route, per week.

While the Postal Service has been successful at managing the cost of delivery, the tools currently available to the Postal Service are not sufficient to reduce delivery costs to the extent now necessary due to declining mail volumes. One of the limitations to reducing delivery costs is the statutory requirement to visit every delivery address six days a week. The number of delivery days is a fixed cost that does not vary with mail

volume. For this reason, the Postal Service is pursuing statutory change that would allow it to reduce the number of delivery days. Removing a day of fixed costs from the system would result in significant cost savings. The current estimated cost savings of moving from six-day a week to five-day a week delivery is \$3.3 billion.

3) Retail

In the last several years, the Postal Service has expanded retail access through various alternative channels including the internet, partnerships with consignment shops (e.g., grocery stores), carrier-pick up, and self-service kiosks. Almost one-third of retail transactions are now completed through alternative channels, without customers entering a Post Office. There were 114 million fewer retail transactions in 2009 than in the prior year. In response to this change, the Postal Service has begun reevaluating the need for all of its retail stations and branches in larger cities to determine if their number is still warranted by customer demand. The Postal Service is not alone in its desire to close retail outlets in response to changing customer needs. Bank of America recently announced its plans to reduce the size of its branch network by 10 percent in response to the changing habits of its customers, who increasingly go online for their banking needs and transactions.¹⁴ Citigroup may sell or close some of its 1,000 retail outlets.¹⁵ In response to lagging sales, Starbucks closed 600 U.S. stores in 2008 and is working to closing an additional 200.¹⁶

b. Labor Costs

The Postal Service is a labor-intensive organization; approximately 79 percent of its total costs are the wages and benefits of its employees. The Postal Service is more labor intensive than private delivery companies due to its particular mix of mail (more letters and small packages than parcels), its capital management (contracting out transportation versus owning airlines¹⁷), and the universal service obligation requirement to deliver to every address, six days a week.

The Postal Service has been moving toward reducing its workforce. As Table B-7 shows, the number of career employees has declined significantly – 22 percent – over the last 10 years.

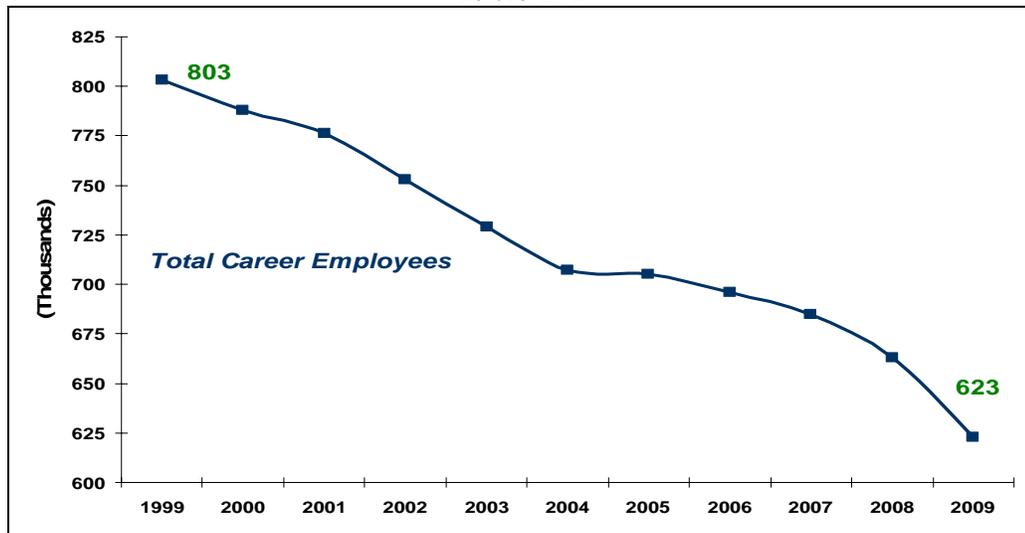
¹⁴ <http://www.dailyfinance.com/2009/07/28/bank-of-america-to-close-10-percent-of-branches/>

¹⁵ <http://www.bloomberg.com/apps/news?pid=20601087&sid=aeVN.BDkfs98>

¹⁶ Starbucks to Close 300 More Stores. Huffington Post. January 28, 2009. http://www.huffingtonpost.com/2009/01/28/starbucks-to-close-300-mo_n_161979.html

¹⁷ In comparison, FedEx owns the largest airline fleet in the world.

Table B-7



The strategy that was implemented in 2009 was to capture attrition as it occurred, and to offer early retirements to eligible employees and to incent certain groups of employees. The Postal Service offered voluntary early retirements to all eligible employees. The strategy also required the Postal Service to look at the administrative functions and implement a 15 percent reduction last year. These reduction efforts took place at all levels of the organization; reducing the number of Areas from nine to eight and the number of Districts from 80 to 74. The Postal Service plans to continue matching resources to workload which will lead to further reductions. Even with these workforce reductions, the Postal Service has increased service and improved customer and employee satisfaction ratings.

The Postal Service's management of the cost of labor is difficult because of statutory constraints (pension and retiree healthcare) and constraints of collective bargaining. Statutorily the cost of pension and retiree healthcare is set by law and the Postal Service has no control over these costs. The Postal Service has a long collective bargaining history and changes in this collective bargaining process are difficult and not dynamic.

1) Collective Bargaining

The majority of employees are in bargaining units represented by unions. Over 99 percent of these employees are represented by one of four unions – American Postal Workers Union, AFL-CIO; National Association of Letter Carriers, AFL-CIO; National Rural Letter Carriers' Association; and National Postal Mail Handlers Union, AFL-CIO.

Compensation for these employees is determined by collective bargaining, as provided in the 1970 PRA. The Postal Service is covered by most of the provisions of the National Labor Relations Act, and with some exceptions collective bargaining over “wages, hours and working conditions” proceeds in the Postal Service on much the same basis as it does in the private sector.¹⁸ On compensation issues, the PRA provides that comparability with the private sector is the standard the Postal Service should achieve and maintain.¹⁹

While most employee benefits are subject to the collective bargaining process, negotiations are limited by the fact that certain major benefits are established by statute and, thus, outside the scope of collective bargaining. For example, the PRA mandates that the Postal Service must provide for its employees fringe benefits that are no less than they were on July 1, 1971.²⁰ While the extent of this requirement is not clear, it represents a potential restriction on the reach of collective bargaining.

One of the most significant differences between bargaining in the private sector and bargaining in the Postal Service is that postal employees are not permitted to strike.²¹ Instead, when the parties’ negotiation efforts reach impasse, the law provides that they may adopt an agreed-upon method for determining the terms of the next labor contract. Failing agreement on such a procedure, the law establishes an impasse dispute resolution process to follow.²² This process currently includes the following principal features:

- Failure to reach an agreement by the expiration date of the contract results in the Director of the Federal Mediation and Conciliation Service (FMCS) appointing a mediator to help resolve the dispute.
- If no agreement on a new contract is reached within 60 days, an arbitration panel is established. The panel is composed of three members: each of the parties chooses a member and the third member is selected either by agreement of the parties or by alternate striking from a list of names provided by the FMCS.
- The arbitration panel is directed to hold a “full and fair hearing” and to issue its award within 45 days of appointment. The panel’s decision is “conclusive and binding.”

¹⁸ 39 U.S.C. 1208.

¹⁹ 39 U.S.C. 101(c), 1003(a).

²⁰ 39 USC 1005(f).

²¹ 39 U.S.C. 410(b)(1).

²² 39 U.S.C. 1207.

This procedure must be used unless both parties agree to modify it. However, the statute expressly permits the parties to adopt their own dispute resolution procedures. In practice, the parties have frequently modified the procedure, especially regarding waiver of the pre-arbitration step (mediation or fact-finding), determining the method for arbitrator selection, and adjusting time limitations. Over the course of history with its four major unions, 18 national agreements have been reached voluntarily, while 14 required interest arbitration.

For employees who do not have collective bargaining rights, the PRA provides for the recognition of management and supervisory organizations who through a “program of consultation. . . shall be entitled to participate directly in the planning and development of pay policies and schedules, fringe benefit programs, and other programs relating to supervisory and other managerial employees.”²³ Specifically, the Postal Service must consult with recognized management organizations over proposed pay changes and strive to reach agreement. Management organizations have the right to take their objections to the Postal Service’s decisions on management and supervisory pay to a neutral fact-finding panel, which can issue recommendations that the Postal Service must further consider.²⁴

2) Statutorily-Mandated Labor Costs

As mentioned above, certain major benefits are established by statute and, thus, outside the scope of collective bargaining. Most importantly, the Postal Service as federal entity participates in federal employee retirement and retiree health benefit programs as required by statute.²⁵ These programs, the Civil Service Retirement System (CSRS) and the Federal Employees Retirement System (FERS), are administered by the Office of Personnel Management (OPM). Changes to these systems that impact traditional federal agencies also affect the Postal Service. For example, a law that was recently passed to allow members of FERS to have unused sick leave credited to them when they retire will add approximately \$50 million in costs per year to the Postal Service.

Career federal and postal employees hired before January 1, 1984, are covered by the CSRS (unless opted to change to FERS), which provides for a basic annuity to which both the employer and the employee contribute at rates prescribed by law.

²³ 39 U.S.C. 1004(b).

²⁴ 39 U.S.C. 1004(f).

²⁵ 39 U.S.C. 1005(d).

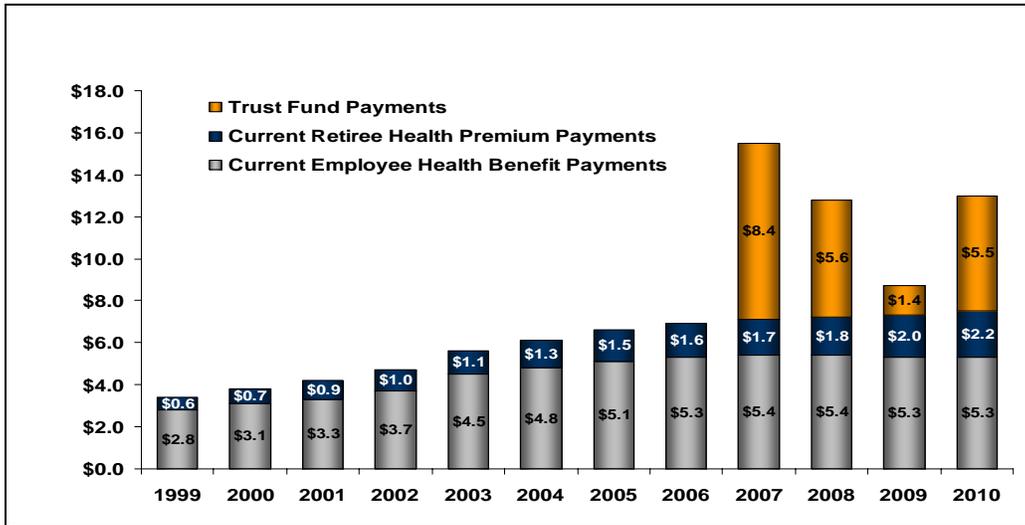
Career federal and postal employees hired since January 1, 1984, are covered by the FERS, which consists of a smaller basic annuity, the Thrift Savings Plan (TSP), and Social Security. Both the employer and the employee contribute to Social Security and the basic annuity plan at rates prescribed by law. At the end of 2008, more than 79 percent of career postal employees were covered by the FERS. The 2008 cost of FERS was \$5.9 billion, of which \$2.9 billion was accounted for by the employer contribution of 11.2 percent to the basic annuity.

In addition, postal retirees may continue to participate in the Federal Employees' Health Benefits Program (FEHBP), which is also administered by OPM. Postal employees with at least five consecutive years participation in the FEHBP immediately preceding retirement are entitled to continue to participate during retirement. Contribution rates of approximately 71 percent by the Postal Service and 29 percent by the retiree are set by statute at the same level as those established for federal employees and retirees generally. This cost for the Postal Service was \$1.9 billion in 2009.

The retiree health benefit premium expense increases each year as a result of medical insurance inflation and the rising number of postal retirees and their survivors, now over 450,000. By far the Postal Service's greatest labor cost issue is the unique requirement to prefund retiree health benefits to an extent far beyond that required of other agencies and private sector employers. The Postal Act of 2006 requires an annual payment ranging from \$5.4 to \$5.8 billion, part of an ongoing 10-year obligation to prefund future retiree health benefits.

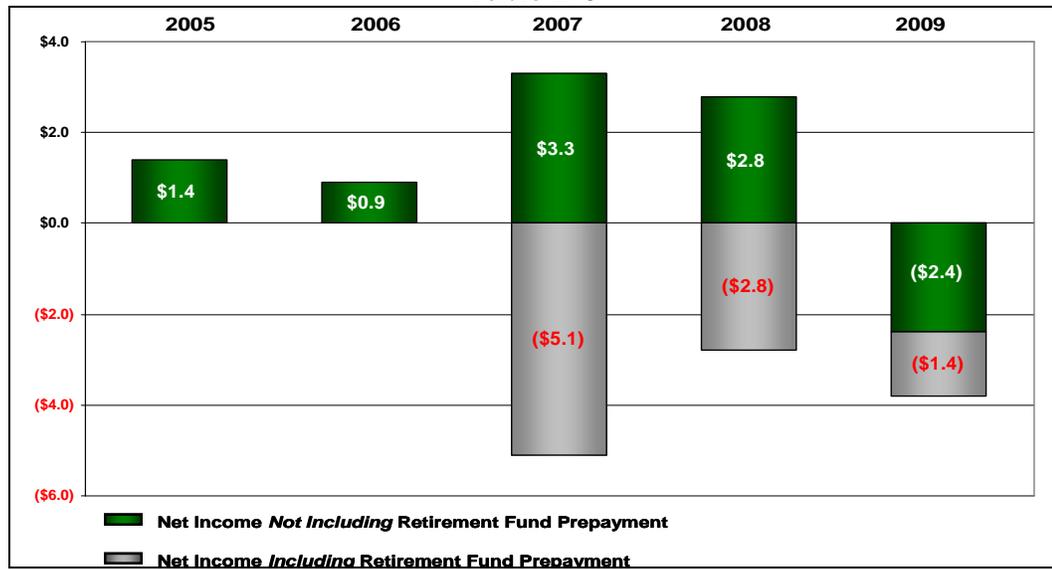
Table B-8 shows the impact of the requirement to pay into the retiree health benefit fund. While the Postal Service's required payment in 2009 was reduced by \$4 billion, this relief is for 2009 only, and that \$4 billion was only deferred until 2017. This \$1.4 billion payment was on top of the \$2.0 billion payment for the employer's portion of current retirees' health benefits costs and \$5.3 billion for current employee benefits. Even with the financial relief, the Postal Service's total health care benefit cost in 2009 was \$8.7 billion and accounted for 13 percent of total revenues in 2009. In 2010, without relief from Congress, the estimated total health care benefit cost is \$13 billion, almost 20 percent of estimated revenue and equivalent to 8 cents per mailpiece.

Table B-8



The requirement to prefund retiree health benefits is so burdensome that it is the driving factor behind the Postal Service's current losses. As can be seen by Table B-9, the Postal Service would have realized a profit in 2007 and 2008, and had an overall profit of almost \$4 billion over the 2007-2009 timeframe, had there been no prefunding requirement. If this requirement is not eliminated or restructured, the obligation and resulting payment stream should be recalculated, since there is reason to believe the actual obligation has fallen as a result of the shrinking workforce. The total amount of the estimated retiree health benefits obligation depends on an assumption about the number of career employees, which has been significantly reduced since the original assumption was made and will continue to fall. This issue has been noted by both the OIG and the PRC.

Table B-9



Bargaining unit labor cost is 64 percent of total costs, and the majority of bargaining unit costs are covered by collective bargaining. Collective bargaining, with its limitations is difficult to change and cost savings from within this collective bargaining framework are not easily or quickly achieved. The Postal Service, with its legal requirements and collective bargaining model cannot achieve the cost reductions or speed of change that its private sector competitors are able to achieve.

c. Future Challenges to Managing Costs

The Postal Service has aggressively moved to cut costs from its system. At the same time, it has improved service and in most years, improved productivity. But despite ongoing efforts to aggressively cut costs, the Postal Service is limited in what it can do.

Mail volume is expected to continue to decline. In 2010, single-piece First-Class letter volume is projected to have declined by 50 percent since its peak in 1996. The Postal Service is currently facing the legacy costs of a large infrastructure, some of which is no longer needed. Network changes are often met with political resistance. Closing facilities and the resulting changes in social and convenience factors frequently lead to protests at both local and national levels, and Congress often blocks changes through legislation. This political resistance is not unique to the Postal Service; for example, military bases have also met with resistance. Unfortunately, postal customers ultimately are forced to absorb the costs of political decisions to keep facilities open.

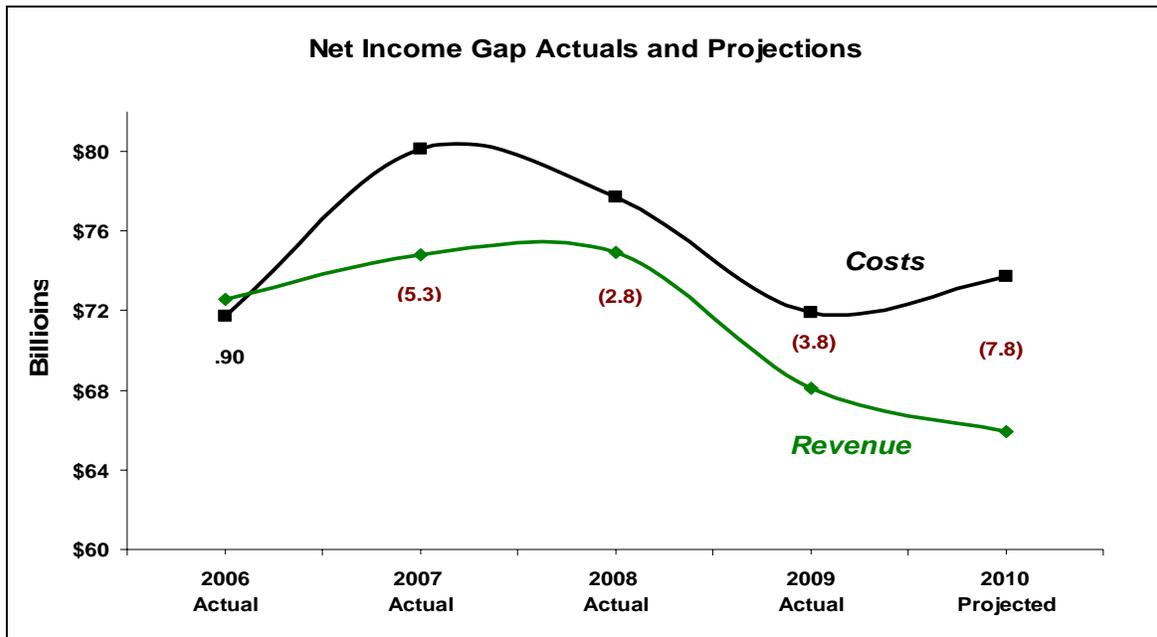
To realize costs savings when closing facilities or reducing the number of carrier

routes, the Postal Service will have to reduce the number of its employees. Union contracts provide "no-layoff" provisions for most employees along with other protections. Accordingly, the Postal Service must rely on attrition as its primary means of reducing complement. The Postal Service's unique current workforce demographics, with a large percent of employees approaching retirement age, are key to reducing the workforce. In order to realize the full savings potential from the retirement incentive programs, the Postal Service needs to be able to make changes to its networks soon. Otherwise, it will need to hire employees to fill the retirement vacancies in order to meet service obligations, and the opportunity to reduce the workforce through normal retirement attrition will be gone.

3. Net Income Gap

There are limits to what the Postal Service can do to further reduce costs and generate revenues. The result of those limits is a profitability gap, beginning in 2007 (Table B-10). The net loss in 2009 was \$3.8 billion; it would have been greater had Congress not allowed the Postal Service to reduce its 2009 payment to the Retiree Health Benefits Fund by \$4 billion. The current projected net loss for 2010 is \$7.8 billion. (This estimate is based on multiple macroeconomic assumptions including GDP, Consumer Price Index (U), investment, employment and Postal Service specific factors such as volume, revenue and cost reductions; it also assumes there will be no change to the current law. The 2010 plan will be adjusted during the year as new data becomes available.) The Postal Service projects that without significant changes to its business model, net income gaps will continue for the foreseeable future.

Table B-10



C. Regulatory and Governance Model Does Not Give Postal Management Necessary Tools to Manage

The Postal Service is an independent establishment of the executive branch of the Government of the United States,²⁶ with multiple layers of regulatory oversight. The Postal Service has an 11-member Board of Governors, nine of whom are appointed by the President. The Postal Service also has oversight from the GAO, an independent USPS Office of the Inspector General (OIG), and by a number of Congressional committees and subcommittees, and is subject to relevant laws Congress may pass. There is additional oversight in that certain decisions can be appealed to Federal Court.

The Postal Service also has oversight from its regulator, the Postal Regulatory Commission (PRC), which now has its own independent Inspector General. The USPS OIG and the PRC and its OIG are fully funded by Postal Service revenues, although the Postal Act of 2006 requires Congress to approve the funding.²⁷

Prior to the passage of the Postal Act of 2006, the respective roles of the Board of Governors and the regulator were clearly drawn. The Board was responsible for the daily operation of the Postal Service, while the PRC (then named the Postal Rate

²⁶ 39 U.S.C. 201.

²⁷ The budget request for 2010 for the PRC (including the PRC OIG) was \$14.3 million and for the USPS OIG was \$244 million; House Report 111-202 – Financial Services and General Government Appropriations Bill, 2010.

Commission) was to regulate pricing. However, the Postal Act of 2006 blurred these lines. While the Board retains the official role of managing the operations of the Postal Service, the PRC now has some ability to impact these decisions through its increased regulatory power.

The PRC has broad authority under the law, including the ability to develop rules around the price setting process, confidentiality, and complaint cases. The Postal Act of 2006 gave the PRC new enforcement tools, including subpoena power, and authority to levy fines in cases of deliberate noncompliance with applicable postal laws.²⁸ The PRC has the authority to hear complaints and to direct the Postal Service to adjust rates and to take other remedial actions when a complaint is found to be valid. To some extent, the Postal Service's flexibility depends largely on how the PRC develops and implements these practices.

Moreover, the Postal Act of 2006 provided the PRC the power to determine reporting requirements. While it makes sense for the PRC to be able to impact the data it receives, this rule allows the PRC to drive decision-making on even the smallest issues – including the ability to update or change a pricing data system or cost study that supports the pricing structure. The PRC's interpretation of transparency is to require the Postal Service to get advance approval for all proposed updates or changes before they can be incorporated into the annual compliance report, sometimes resulting in lengthy public debates that can focus more on the consequences of a proposal, rather than its technical merit. Moreover, because many methodological issues regarding the reporting process do not surface until the actual reports are under preparation, the Postal Service often faces the dilemma of either ignoring a problem, or initiating a proceeding that cannot be completed until after the reports are due. The ultimate result of this process may impede, rather than enhance, the Postal Service's ability and willingness to explore and propose changes that would result in more valuable or more accurate data.

Regulation does and should play an important role in managing a government organization. However, the regulation over the Postal Service appears to be onerous when compared to the regulation of other posts. The PRC's perceived need for transparency appears to drive many of the reporting requirements. In most other posts, transparency refers to the data shared between the post and its regulator, and does not refer to publicly available information. This becomes especially important related to

²⁸ 120 Stat 3239 (Subpoena) and 120 Stat. 3216 (Fines).

competitive product information. Only three posts – Denmark, Iceland, and the UK – publish regulatory accounts in a public forum.

The relationship between the Postal Service and its regulator, the PRC, is a unique one-to-one relationship. In other countries, and in other industries in the United States, a regulator oversees multiple postal licensees and/or other industries, not just one organization. Another example of a one-to-one regulator relationship has been hard to find. The most similar example is the UK, where an independent panel recommended significant changes to the regulatory structure. Perhaps the most significant recommendation with regard to the regulatory structure was that Ofcom, which regulates the broader UK communications sector, should replace Postcomm, which regulates the postal industry (including the post and licensees).²⁹

D. Business Model and Regulatory Model Need to Enable the Postal Service to Take into Account the Future Needs of Customers and the Market

The Postal Service has numerous types of customers including households; small and large businesses; non-profit organizations; local, state and federal governments including Congress; companies that presort and/or consolidate mail before entry; and even competitors that leverage the last mile of delivery. In addition, the Postal Service delivers products and services to and from other countries.

By statute, the mission of the Postal Service is to “bind the Nation together.”³⁰ This is typically thought of as providing hard copy delivery. Historically, however, the mission of the Postal Service has been broader, and has included educating and informing the public, enabling commerce, and representing the federal government in local communities. The key to determining the appropriate future business model of the Postal Service is clarifying its mission. What future role does the nation, the market, and customers need the Postal Service to play? The various roles that the Postal Service has traditionally served and potential future roles are discussed in the following section.

1. Mail Services

a. Traditional Role of Mail

Mail services include personal communication and information dissemination, bills and financial transactions, merchandise delivery, and advertising. Each is discussed below.

²⁹ Hooper *et al.*, "Modernise or Decline: Policies to Maintain the Universal Postal Service in the United Kingdom"; p. 88 (2008).

³⁰ 39 USC Sec 101 (a).

1) Personal Communication and Information Dissemination

Personal communication and information dissemination are perhaps the most iconic of the Postal Service's traditional roles in binding the Nation together. Indeed, the Post Office was originally created to ensure that information passed as freely and quickly as possible within a country whose population was far-flung and relatively isolated. Especially in the early years, the Postal Service was vital to the development of democracy, a role that the Postal Service still plays today through voting by mail. Within the realm of personal communications and information dissemination, there have always been two distinct mail streams: correspondence and various news publications (periodicals). Even though these two types of mail have always been distinct, both are about transmitting information and have been affected by the evolution of technology.

2) Business and Financial Transactions

One of the most important traditional roles of the Postal Service has been to facilitate financial and commercial transactions within a large, geographically diverse country. More than any other country, the U.S. has relied on mail order and mailed bills and payments in the development of its commercial and financial systems. The total value of transactions moving through the mail each year is \$30 trillion.³¹ While households still pay a majority of their recurring bills through the Postal Service³², the movement toward electronic alternatives is growing. Total transactions volume sent and received by households – including bills, bill payment, rebates, and charitable requests and donations – declined by 2.4 percent from 2006 and 2008.³³ Bill payment by mail declined 2.5 percent during the same time period. In 21 percent of households, online payment is used for some portion of bill payments, with 10 percent of households not using mail for any bill payment.³⁴ As broadband access increases, more households will pay more bills online and are also likely to receive bills exclusively online instead of through the mail.

3) Merchandise Delivery and Returns

Not all Postal Service roles are diminishing. In particular, the market for parcels is burgeoning. The trends that have driven consumers to seek news and information over

³¹ USPS Strategic Business Planning, Market Research, and Financial Forecasting.

³² Currently, 90 percent of households use mail to pay some portion of their household bills, with payment by mail accounting 56 percent of total household bills. Source: 2008 Household Diary Study.

³³ 2008 Household Diary Study. <http://www.usps.com/householddiary/>

³⁴ Ibid.

the internet have also led to an expansion in online shopping. This, in turn, has created growth in parcel shipping for order fulfillment, one of the Postal Service's traditional strengths. As the market for merchandise delivery and returns expands, the Postal Service has exploited its current first- and last-mile strengths and expanded its presence via partnerships with other carriers.

4) Advertising

The market for mail advertising is also still very relevant. Mail has a unique advantage for some advertisers because it is an excellent medium for reaching a specific audience, and the results can be readily measured. Advertising in other communications vehicles such as newspapers and television goes only to their respective subscribers or viewers. With the right address list, mail can be geographically or demographically targeted in a precise manner. Advertising mail has high response rates and generates a good return on investment, especially as part of a coordinated multi-channel effort. This remains true today, although the increasing costs of mailing (including the cost of paper) have begun to erode mail's traditional advantage in this area.

5) Postal Money Orders and Wiring Money

Postal Money Orders and wiring money differ from other mail services in that they are alternatives to sending cash. The Postal Service offers domestic and international money orders, currently available to approximately 30 countries. The Postal Service also offers a service to wire money internationally, called DineroSeguro®. The Postal Service is not a dominant participant in the money transfer market.

6) International

The Postal Service is responsible for delivering mail in the U.S. that originates in other countries and accepts mail in the U.S. that destines in other countries. The rates and fees paid to the Postal Service for handling and delivering inbound international mail are not entirely within its control. In the case of letter-post, which is the largest category of inbound mail, the Postal Service settles terminal dues based upon rates established by the Universal Postal Union (UPU), of which the U.S. is a member and the State Department is its representative. Until the enactment of the Postal Act of 2006, price-setting for international mail was not regulated by the PRC. Now both international and domestic prices are regulated by the PRC along with the domestic prices.

b. Future Needs

While the future of mail service is uncertain, it is clear that the future needs of customers will look much different than in the past. This section describes how the needs for mail service may evolve based on current demographic and technological trends.

The Postal Service plays a vital role in the national payment system. Mailed bills, statements, and payments are important parts of the national payments system. While online alternatives to mail are reducing mail volume, mailed statements and checks will remain a substantial portion of the bill presentation/payments streams for some time, and an efficient mail-based payments system is still necessary. Some people will not have access to online payment applications, and others are concerned about the security and privacy of online systems. Others simply prefer paper-based communications for at least some applications. Some companies are repositioning paper statements as customer relationship tools. Also, digitization and technology offer opportunities to make hardcopy more efficient and cost effective, by allowing documents to be further personalized, transmitted, printed, and entered into the mailstream at sites close to the point of final delivery.

One of the fundamental missions of the Postal Service was to establish a national market for publications to help educate and inform. The majority of publications are delivered by the Postal Service. Technology and more targeted publications are changing this model, as the industry continues to drive toward smaller circulation and more specialized publications, and as print editions incorporate more features to link more effectively with online applications. Also, as government agencies become more proactive in reaching out to the public, there is an opportunity to educate and inform the public through outreach to targeted audiences.

The Postal Service is one of many advertising channels in an advertising-intense, consumer-oriented society. The mission of the Postal Service in this market is to help businesses and the economy grow. However, the internet has disrupted traditional media channels. Marketers are responding to increasing consumer resistance by implementing targeted approaches that can demonstrate results. The digital age is coming to direct mail, and will better target and personalize the message. The process to create direct mail will become collaborative, where everything from design to arrangements for delivery can be made online on a single site.

The Postal Service will continue to have an important role in preserving choice in package and logistics services. Cost, reliability, and information on delivery status will remain core attributes of value, and the move to reliable lower-cost services will also continue. Demand for package services will continue to grow, driven by global e-commerce, and the market will be intensely competitive. The industry will remain information-intensive and will require continuing investments in IT. Collaborative information systems will enable service providers – even competitors – to work more closely together to reduce cost, and recipients will have more control and delivery options. Providing information and helping businesses with these processes will be as important as shipping.

2. Fundamental Government Service

a. Traditional Role

The Postal Service was established to operate as a basic and fundamental service to the American public that binds the Nation together through the personal, educational, literary and business correspondence of the people.³⁵ As required by law, it provides free mail for the blind and reduced rates for non-profit mail. In addition, the Postal Service provides services to the public and other government agencies unrelated to the mail. Americans have come to expect and rely on the Postal Service to provide these government service roles. As evidence, a Gallup poll³⁶ conducted in June 2009 reported 95 percent of respondents considered it important that the Postal Service to stay in business, with 66 percent considering it “very important” to them personally.

The Postal Service provides a government presence in all neighborhoods, delivering to more than 150 million addresses. Having carriers on the streets every day is an invaluable way to keep watch on America’s neighborhoods. Although, not required by law, the Carrier Alert Program recognizes that carriers help monitor the well-being of elderly and disabled customers, and carriers throughout the country have saved hundreds of lives by keeping an eye out for citizens. Postal carriers are trusted individuals. The Postal Service has been repeatedly named as the most trusted federal agency by the Ponemon Institute’s Privacy Trust Study.³⁷

The Postal Service has a tradition of collaborating with other government agencies, and currently provides a number of services other than mail delivery. For

³⁵ 39 U.S.C. § 101.

³⁶ <http://www.gallup.com/poll/121268/Americans-Fewer-Mail-Days-Fix-Postal-Budget.aspx>

³⁷ Ponemon Institute. <http://www.ponemon.org/news-2/2>

example, the Postal Service has an agreement with the Department of State to provide passport application acceptance. In addition, the Postal Service plays an important role in national security. Carriers have agreed to participate in the Cities Readiness Initiative, a federally-funded effort to prepare major U.S. cities and metropolitan areas to effectively respond to a large scale terrorist event. Carriers also provide support during natural disasters such as floods, tornadoes, earthquakes, hurricanes, and other emergencies.

As part of its fundamental government service, the U.S. Postal Inspection Service – one of the country's oldest federal law enforcement agencies – is charged with the responsibility of protecting the mail. The Inspection Service helps protect the nation's postal system, preventing and prosecuting crimes by those who misuse mail to defraud, endanger, or otherwise threaten the public. Through its security and enforcement functions, the Inspection Service provides assurance to American businesses for the safe exchange of funds and securities through the U.S. Mail. It also provides postal customers with the "sanctity of the seal" in transmitting correspondence and messages that are sealed against inspection. The strong tradition of trusted delivery, supported by the Inspection Service and the criminal statutes, provides a high level of protection to Postal Service customers.

b. Future Need

What is the future role of the Postal Service as a fundamental government service? The role could be expanded, given its vast nationwide retail network, its trusted image and capable workforce, the Postal Service is in a unique position to assist the rest of the government in carrying out additional services. A number of foreign posts have developed agreements with their governments to deliver new and expanded government services through Post Offices. These "fundamental government service" roles could be assumed by various federal, state, or municipal agencies. Examples are:

- Taking advantage of the national scope of the Postal Service, whether through brick-and-mortar or alternative access, to inform the public about critical issues or to provide access to government services or products.
- Leveraging administrative shared services, especially for smaller agencies, such as accounting/payroll, facilities, and supply chain management.

3. Social Welfare

a. Traditional Role

While it is not always widely recognized, the Postal Service certainly plays a “social welfare role” that encompasses several aspects, but by far the most politically charged is providing middle-class employment across the country. Although it is not recognized in the law as part of the mission of the Postal Service, this role is often an influential driver of political decisions. While, on one hand, Congress has encouraged the Postal Service to streamline its network, it is often resistant to the closing of specific facilities due to the local impact. This resistance is often in the form of proposed new legislation aimed at stopping closings from moving forward. For example, after the Postal Service talked about consolidating its network in the spring of 2009, Congress introduced two bills that would limit the Postal Service’s ability to reduce labor costs and close facilities.³⁸

It is not necessarily inappropriate for the Postal Service to have a social welfare role. The Postal Service is an entity of the federal government. Until the Postal Act of 2006 was passed, the Postal Service’s mandate was to break-even and it was allowed to raise rates in order to cover costs. Therefore, although the pressure to not close facilities often contradicted the goal of operating efficiently, the Postal Service had the ability to raise enough revenue to cover the costs of providing this role. However, the combination of declining volumes and a price cap constraint on products accounting for 90 percent of total revenues makes it impossible for the Postal Service to absorb the cost of operating a larger-than-needed network and still finance universal service.

b. Future Need

In the future, it is unlikely that the Postal Service can maintain its current business model and its current network, and still be able to cover its operating costs through its revenues. Therefore, Congress needs to address this issue head-on. Does Congress need the Postal Service to provide and maintain well-paying jobs throughout the country, either through its current network or by assuring that a new network must provide employment in certain areas? If the answer is yes, then Congress needs to provide the Postal Service with a business model that includes revenue opportunities or

³⁸ H.R. 658, The Access to Postal Services Act, would amend Title 39 and require the Postal Service to follow extensive procedures, prior to closing any retail facility and would also adjust the criteria for making a decision on whether to close a facility, and would prohibit the consideration of the potential economic savings from closing a facility. The second bill, H.R. 1686, The Mail Network Protection Act, introduced prohibitively restrictive rules around contracting out.

subsidies that enable adequate funding to support this role. If the answer is no, then Congress should give the postal service more flexibility to operate efficiently, whether that be through fewer days of week delivery or through consolidating its network.

4. Universal Service Obligation

a. Traditional Role

As mentioned earlier, one of the requirements of the future business model study is that the recommended model must ensure affordable universal postal service throughout the United States.³⁹ The Postal Service's universal service obligation (USO) has been broadly defined by statute. In response to a requirement in the Postal Act of 2006, both the Postal Service and the PRC produced reports on universal service in the fall of 2008. In general, both parties agreed on many aspects of the USO, including that it consist of geographic scope, range of products, prices/affordability, access, delivery frequency, and quality of service. The Postal Service also included security, and the PRC included user rights. Below is a brief discussion of these aspects.⁴⁰

Range of products - The Postal Service and the PRC disagree on the range of products currently covered by the USO. The Postal Service has stated it should be limited to the market dominant products, while the PRC believes that the USO should apply to all products, market dominant and competitive. In general, however, both agree that the USO includes ensuring that the public has viable affordable alternatives.

Geographic scope - In general, the Postal Service is required to provide postal services to all U.S. communities as nearly as practicable, as well as providing service to and from military personnel stationed abroad. Title 39 gives the Postal Service great latitude to meet this obligation. The Commission believes that agreements related to international postal services and international delivery services should also be included in the scope of the USO.⁴¹

³⁹ P.L.109-435 120 STAT 3247.

⁴⁰ Please see the following reports for a more detailed discussion. Postal Regulatory Commission's Report on Universal Postal Service and the Postal Monopoly (2008) at http://www.prc.gov/prc-docs/home/whatsnew/USO%20Report_1.pdf and the United States Postal Service Report on Universal Service and the Postal Monopoly (2008) at <http://www.usps.com/postallaw/universalpostalservice.htm>

⁴¹ Postal Regulatory Commission's Report on Universal Postal Service and the Postal Monopoly (2008) 19.

Prices/Affordability – There must be at least one class of mail provided at prices uniform throughout the United States,⁴² and the price for 90 percent of the Postal Service’s revenues are subject to a price cap.

Access - By statute, the Postal Service must “establish and maintain postal facilities of such character and in such locations, that postal patrons throughout the Nation will, consistent with reasonable economies of postal operations, have ready access to essential postal services.”⁴³ Access traditionally has been through local Post Offices and household mailboxes. However, with increases in technology, access has expanded to include internet, phone, mail, contract postal units, and kiosks. Access in more rural areas includes rural carriers providing services via “Post Office on wheels.” Access also refers to delivery service. Each residential customer is understood to be eligible for one form of free delivery; however, this does not mean everyone receives carrier delivery to their home. Instead, delivery includes many alternatives such as mail slots, mailboxes, cluster boxes, and no fee (Group E) Post Office boxes.

Delivery Frequency - Delivery Frequency is not addressed in Title 39. Instead, the only requirement pertaining to delivery frequency is found in a re-occurring rider on annual appropriations bills. The rider requires the Postal Service to deliver six days a week wherever “practicable.”⁴⁴ However, given the changing market demand and the need to cut costs, the Postal Service has asked for that rider to be dropped and to be given the flexibility to reduce the number of days of delivery.

Quality of Service - The law requires the Postal Service to maintain quality of service through broad requirements including “prompt, reliable, and efficient services.”⁴⁵ As required by the Postal Act of 2006, the Postal Service has developed service standards and measurement systems for market dominant products. The law gives the Postal Service the authority to change these standards.⁴⁶

Security - Prior to the 2008 reports on universal service, security had never been considered an element of the USO. However, during the public outreach conducted in

⁴² 39 U.S.C. 404(c).

⁴³ 39 U.S.C. 403(b)(3).

⁴⁴ There are some instances where the Postal Service delivers fewer than six days a week including businesses that are only open five days, remote areas that are difficult to access, and areas where residents live only seasonally.

⁴⁵ 39 U.S.C. 101(a).

⁴⁶ 39 U.S.C. 401 (10).

the preparation of those reports, it was revealed that mailers considered security an important element of USO.⁴⁷

User Rights - In its report, the PRC argued that an element of the USO is the ability of interested parties to file complaints for “failure of the Postal Service to meet the requirements of certain specific statutory provisions.”⁴⁸

b. Future Need

The future need for universal service is not clear. During the development of the Postal Service and PRC reports, mailers stressed that the most important elements of the USO to them were affordability and geographic reach. While other elements were highly valued, mailers acknowledged the trade-off between costs and service and were willing to forgo some service, specifically delivery frequency, to keep rates affordable. Recently, there have been various articles and surveys, including a recent Gallup survey, showing that the majority of the public would prefer five day a week delivery over an increase in rates, government subsidy, or Post Office closings.⁴⁹

As technology continues to drive more customers to alternative access and electronic alternatives, and mail volume becomes more heavily weighted toward advertising mail, the public’s view of what is needed in terms of universal mail service will continue to change. There may be a time when a government agency is no longer needed to provide universal mail delivery. However, there are certain geographic areas and demographic groups that will need someone to provide universal postal services for years to come. For example, many communities in Alaska have long depended on the Postal Service to delivery food and other basic necessities. Even in the continental U.S., people in remote and lower income areas depend on the Postal Service for low cost delivery. In addition, there are still many people who do not trust or have access to the internet for bill payment or correspondence. Therefore, the Postal Service – or another entity – must continue to meet the evolving needs for postal products.

E. Future Business Model Alternatives

This section examines future business model alternatives for the Postal Service. Each represents a departure from the current structure, varying from small adjustments to dramatic changes. One end of the spectrum is a federal government agency partially

⁴⁷ Docket N. I2008-3, USO Field Hearings, TR. Washington D.C, p 10, lines 2-5.

⁴⁸ Postal Regulatory Commission’s Report on Universal Postal Service and the Postal Monopoly (2008) 21.

⁴⁹ June 2009 Gallup Survey. <http://www.gallup.com/poll/121268/americans-fewer-mail-days-fix-postal-budget.aspx>

supported through Congressional appropriations, with the government determining the services provided to the nation. The other end of the spectrum is a fully privatized postal system, dependent on market supply and demand to determine scope of delivery, pricing, and the services offered along with significantly greater flexibility to manage the business.

There is no one “right” model that fits all posts. Foreign posts have a variety of business and regulatory models, and the origin and evolution of these models are deeply rooted in the underlying economic, political, social, cultural and geographic history of each country. Models vary by the priorities of each country – priorities may be focused on social and political goals, or more on economic considerations.⁵⁰ Therefore, in order to determine the best future business model for the United States Postal Service, the nation’s needs and priorities must be first identified.

1. The Postal Service Remains a Self-Sustaining Federal Entity, But Is Granted New Flexibilities

One business model alternative is a scenario where the Postal Service remains an independent establishment of the executive branch of the federal government. It would maintain the responsibility to fund most or all of its operations through its revenues. In order for the Postal Service to achieve financial viability, Congress would need to grant it new flexibilities to control costs and to raise revenues. Specifically, the Postal Service could be given more ability to control costs through elimination of the appropriations rider that requires six-day a week delivery, the elimination of the law that places restrictions on Post Office closings, and the reduction of Congressional intervention related to facility closures. Additional flexibilities could include making all the finances of the Postal Service off-budget, giving it the ability to negotiate statutorily-mandated employee benefits, and granting it near and medium term relief from the requirement to prefund the retiree health benefits obligation. The Postal Service could be given more flexibility to generate revenue through the offering of nonpostal products and services, focusing on those areas that leverage the Postal Service’s assets and where the public would benefit from the government providing the service. Part of the additional flexibility granted to the Postal Service could be less stringent regulation, so that changes could be made more quickly and without undue hurdles.

⁵⁰ Campbell, Robert. *Regulatory and Governance Changes in Liberalized Commercialized Postal Environments: A Comparative Assessment*. In *Future Directions in Postal Reform*. 2001.

The main advantage of this model is that it allows the Postal Service, as a trusted government agency, to fulfill its obligation to provide affordable universal service, without relying on tax dollars. This model has the potential to reduce employee-related costs through increased flexibility to manage costs. This model would work well if Congress and the public are open to giving the Postal Service real flexibility and enabling it to make business-like decisions, as the Postal Reorganization Act of 1970 intended.

The main disadvantage of this model is that without comprehensive structural changes to reduce political interference, it leaves the Postal Service with the same problem it faces today, attempting to serve several roles that are at odds. While in theory the right flexibilities could alleviate some of the current problems, experience has shown that these flexibilities do not exist in practice. Therefore, it is questionable whether the Postal Service would gain enough flexibility to survive unless stakeholders agree to give it flexibility in both theory and in practice.

2. The Postal Service is a Federal Government Agency Supported by Appropriations

Under this business model alternative, the Postal Service would continue its current functions. But, unlike today's self-funded Postal Service, it would do so as a regular federal government agency supported by appropriations. This model would be most suitable if Congress and the American people determine that the Postal Service is an essential government function and, as such, would be willing to provide appropriations to support its mission. Historically, the U.S. government has subsidized several industries, including telecommunications and the railroad industry, in order to ensure the public service need is met.⁵¹ Under this model, Congress would determine the level of service provided, including the definition of universal mail service, postal pricing, facility closures, and the role of the Postal Service as a government presence. Even in countries with liberalized posts, the universal service provider (USP) often receives compensation for providing USO.

The Postal Service could be allowed to venture into other areas of business, limited to where there is a public need for the government to provide the service. The Postal Service could also provide services for other government agencies, similar to how it provides passports today. Safeguards would need to be put in place to prevent the return of problems of the pre-1970 Post Office Department, such as political patronage, poor service, strikes, and backlogs of mail.

⁵¹ See Appendix B for more detailed discussion.

One advantage of this model is that it eliminates the tension that exists between the Postal Service's status as a governmental agency and its mandate to be self-supporting. This model guarantees that the American public will continue to receive affordable universal service, even with rapidly declining volumes. This business model also has the benefit of tying political decisions to the funding responsibility for those decisions. For example, if Congress does not want facility closures, it will have to continue to fund those facilities. This also holds true for the multitude of services the Postal Service is required to provide. A reduction in these services and requirements would provide for the reduction in the need for appropriations.

The main disadvantage of this model is taxpayer burden, especially given the deficits in the current economic environment. Another disadvantage is that with this type of model in the past, pre-1970 PRA, there was little to no capital investment because the annual appropriations cycle and related laws made it very difficult to implement multi-year capital projects. Investment in capital is needed to increase, and even maintain, efficiency. This model could also result in competitors arguing for even more limits on competitive products. There may be pressure to restrict or eliminate advertising mail and package delivery in some manner, and mailers and consumers could be negatively impacted by fewer available alternatives.

3. The Postal Service Owns and Maintains Only the Delivery Network

This model focuses on the concept that the delivery network could be considered a natural monopoly and therefore should be government owned. Under this model, the Postal Service might also maintain its retail network. However, the processing and transportation network would be opened up to privatization. In theory, this would allow private industry to recreate a more efficient processing network, although in practice it could lead to redundancies. The Postal Service might have to maintain some processing capability in order to sort mail into the sequential order of a carrier's route, as is done today. If the postal network were split, it is unclear if revenues would be sufficient to cover costs. Therefore, it is possible this model could result in a need for appropriations. The Postal Service could be allowed to offer other services, especially government-related, if those services leveraged the delivery or retail network.

This model has potential to lead to significant labor reductions, as the Postal Service would only be responsible for costs related to delivery, and possibly retail operations. The Postal Service would receive revenues for delivery and retail services.

This model offers the public continued affordable universal service as costs will potentially be reduced and appropriations will be given if necessary. The Postal Service may be able to significantly reduce costs by shedding its processing and mail-processing-related transportation network. This model could have the added benefit of encouraging a green delivery system, one in which other companies are encouraged to use the Postal Service for last mile delivery, cutting down on the number of delivery vehicle on the roads.

The main implications of this model are the loss of postal jobs and impact to service quality. While some of these jobs could be absorbed by private industry, it is unlikely that this will translate into similar jobs with similar wages in the same geographic area. Since the goal of this model is to promote a less costly network, this model will most likely result in lower paying and fewer jobs. This model also has a layer of complexity in that the Postal Service could be dealing with multiple mail providers and would need to work with each on how to best prepare the mail. There is also no guarantee that this model would allow the Postal Service to generate enough revenue from its products. The Postal Service would still incur large fixed costs associated with delivery and retail. The delivery network is expanding each year and the number of pieces per delivery is declining. The delivery and retail functions are labor-intensive and future efficiencies will be limited.

The transition strategy would have to include a plan for how to best sell off postal facilities, including how the proceeds would be distributed. This model may be appropriate if Congress wishes to capitalize on the Postal Service's efficiency in delivery and allow the processing network to be handled by the private sector. To ensure affordable universal service, this will most likely result in a growing amount of appropriations, coupled with reductions in delivery service.

4. The Postal Service is Liberalized

The liberalization business model has many variations, as can be seen in foreign posts. In general, liberalization means that the government maintains ownership of the post, but grants it the ability to manage itself like a business. The trade-off for the new flexibilities is often the reduction or elimination of the monopoly over some time period. In the U.S., the monopoly includes both the monopoly on the delivery of letter mail and the Postal Service's exclusive access to the mailbox. These monopoly protections help fund the Postal Service's current universal service obligations.

In a regulatory environment in which the market has been fully liberalized and there is no longer a postal monopoly, new entrants would be free to cream skim to capture the profitable volumes, leaving the post primarily with the unprofitable ones. This could cause the cost of providing universal service to rise or the level of service to decline.

As other posts have liberalized, they have received supporting measures to protect their ability to fund universal service obligations. Many posts are able to counter the effects of increased competition through diversifying their sources of revenue, including offering enhanced services such as banking, financial services, and logistics. Other posts cope with the effects of competition and USO requirements through receipt of direct governmental subsidies or licensing fees from competitors to ensure funding.

In order to reduce the impact on the country and on the postal workforce, changes would be gradual. The market would be gradually opened and allow licensees to deliver mail. The Postal Service and licensees would have the same type of regulation. The key to this model being successful is that the Postal Service is allowed to venture into other activities to provide adequate revenues. The more liberalized the postal market becomes, the more the Postal Service should be allowed to expand into other areas. The question this model brings to light is what happens if the Postal Service fails. Would Congress be willing to step in and fund postal services or contract out the services that are still needed?

One advantage to this model is that the Postal Service would be able to better manage its business through additional revenue generation and a greater ability to control costs through the ability to optimize its network and workforce. However, there are some disadvantages. There is no guarantee that the revenue earned through increased flexibilities will offset the revenue lost from the elimination of the monopolies. In addition, this model has the potential to have a negative impact on current employment. Furthermore, the loss of funding of the USO – through the reduction or elimination of the monopolies – could lead to need for reduction in the USO. In addition, a case study of the UK showed that, while businesses benefitted from liberalization, consumers did not.⁵²

5. The Postal Service is Privatized

Another option is to privatize the Postal Service, a dramatic measure requiring sweeping changes. The Postal Service would cease to be a government agency, and

⁵² See Appendix C for more detailed discussion.

instead would be operated as a private business owned by investors. This new private post would have shareholders and would compete with other private businesses to provide postal services. The postal monopoly would be reduced or eliminated. The Postal Service would be free to enter into any other businesses it saw fit, and it would be allowed to fail.

This model allows for greater flexibility in both revenues and costs. The Postal Service would have the ability, without political interference, to right-size its network through the closure of Post Offices and processing facilities. Those who support privatization point to the economic efficiencies of allowing market supply and demand to determine pricing and services offered, and point to the assumption that competition would likely give rise to innovation and a more agile customer responsive entity.

A look at opening up the market to competition in other industries shows that it is not always beneficial to consumers. In a number of states, including California and Montana, the experience of deregulation has been one of volatile electricity prices and decreased reliability in service, as evidenced by rolling brownouts in California.

A look at postal privatization in other countries shows prices far greater than in the U.S. The new private post would lose the economies of scale inherent with processing and delivering the entire nation's mail. The most likely outcome is that postal providers will quickly fill in to serve the higher volume, profitable areas of the country, leaving higher cost rural and inner city urban locations without affordable service. In order to ensure universal service, subsidies would be required either through tax dollars or through postal licensees paying universal service fees. The current feature of nationwide affordable and uniform pricing might be eliminated, as private businesses would want to charge more to deliver to higher cost areas. The elimination of the mailbox monopoly may raise concerns about the safety and security of the mailbox, if parties other than the Postal Service have access.

There is a good chance Post Offices would close, and services citizens have come to expect would no longer be available. An important question is would the Postal Service be able to find investors and equity if privatized, given that it has negative equity and operates in a declining industry. This model would not be appropriate if Congress needs the Postal Service to fill any government service roles, or is concerned with maintaining affordable and uniform pricing.

F. Conclusion

As discussed above, each business model scenario comes with its own set of tradeoffs and risks. While there is an ongoing movement from hard copy mail toward electronic alternatives, the need to conduct financial transactions by mail will continue so long as consumer access to and trust of the internet is not universal. The need for affordable, reliable package services will also continue. These needs tend to be greatest in the very areas that a private provider would either overprice or limit services. This supports a conclusion that the Postal Service should maintain its responsibility for supplying affordable universal service.

But the current business model is not sustainable, and Congress has said it wants a solution that does not involve Postal Service reliance on appropriated funds. Thus, in order for the Postal Service to be self-sufficient in years to come, Congress must give it additional flexibilities to manage its costs and increase its revenues.

The Postal Service has researched other posts and industries, and solicited as well as received others' perspectives on the business model or models that would be most appropriate to ensure continued and viable postal services for the country. This is just the beginning of what the Postal Service expects to be a comprehensive discussion of all the potential options for change. Table F-1 contains a list of potential options that would have a significant impact on the Postal Service's finances. This list is not meant to be comprehensive or definitive; it simply includes the more significant policy options analyzed to date.

Table F-1

<u>Options for Improving USPS Finances</u>	
<ul style="list-style-type: none">• Abolish or restructure required prepayments for future retiree health benefits• Eliminate 6-day delivery requirement• Consistent off-budget treatment of USPS• Permit facilities to be closed for solely economic reasons• Reduce retail outlets, rely more on alternative access channels	<ul style="list-style-type: none">• Diversify/expand product and service offerings• Implement demand-based pricing• Expand ability to partner with private sector• Provide more non-postal government services• Increase workforce flexibility• Enhance ability to outsource• Change worker's compensation process