PostCom

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BULLETIN THE JOURNAL OF POSTAL COMMERCE

HIGHLIGHTS

» PRC Issues USPS FY2018 Financial Analysis

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» Senators Vet BOG Candidates

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» Senators Examine the Postal Service's financial condition

Homeland Security and Governmental Affairs Committee head a hearing on April 30, 2019 to review the current financial condition of the Postal Service, as well as the urgent need for reform legislation. As a result of bipartisan demands at the hearing, the Postmaster General will provide a turnaround business plan by early July.

PRESIDENT'S CORNER

"Solving" the Wrong Problem

Last week the Postal Regulatory Commission (PRC) issued its FY2018 Financial Analysis Report (FAR). There isn't much new in it. After all, the fiscal year ended seven months ago. Apart from the PRC's Altman Z-score analysis, most of the report is a helpful repackaging of information that is already available in the Postal Service's financial statements or Annual Compliance Report (ACR). The report's issuance allows the PRC to check a box, but will have limited practical impact. Unfortunately, the report was heralded by a press release (release) that hints at significant and irresponsible things to come.

In announcing the report, the release provides a summary of findings and conclusions in bulleted form; the first of which is "Consumer price index (CPI)-based price increases were not enough to offset revenue lost from declining volumes." It has been said before, but let's say it again; CPI price increases are not – and were never – designed to cure all of the ills facing the Postal Service. When volume declines, regulated monopolies are expected to reduce costs, trim operations, increase productivity, et cetera. Inflation indexed price caps are designed to provide an incentive for efficiency while allowing for increases in factor prices.

A later bullet notes that "Total Factor Productivity (TFP) increased slightly compared to FY 2017". Slightly indeed; 1/10 of a percent. If last year's rate of productivity improvement continued unabated – far from a certain prospect - TFP will not reach 2014 levels until 2025. Given that productivity growth is cumulatively negative over the last five years, one wonders why the PRC didn't say 'productivity increases were not enough to offset revenue lost from declining volumes'. Several explanations present themselves, none of which offer much reason for optimism.

Most charitably, the PRC is just parroting the Postal Service's talking points here. As has been well documented, the Postal Service believes there should be no constraints on its ability to increase prices on its monopoly products as a way – arguably the only available way – to meet its financial challenges. It

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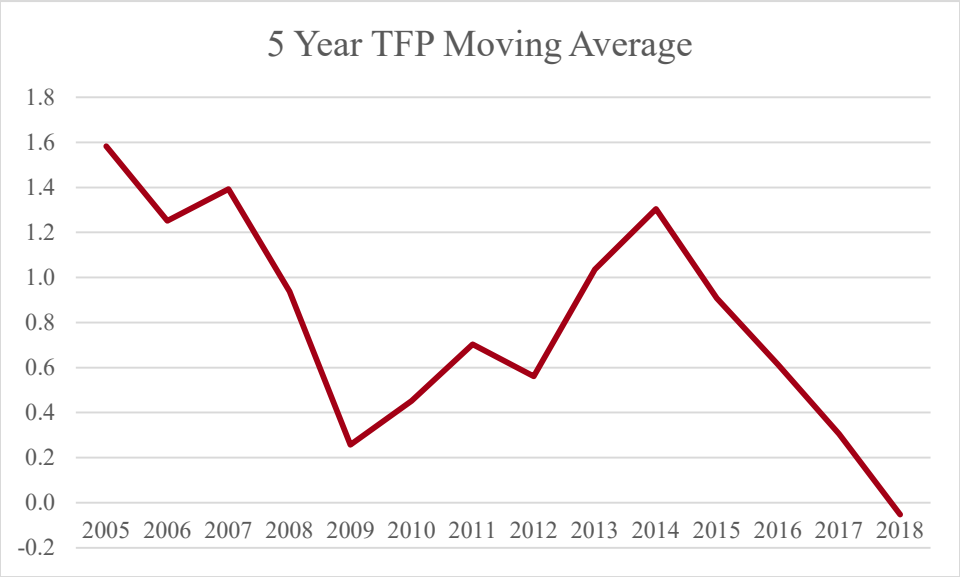
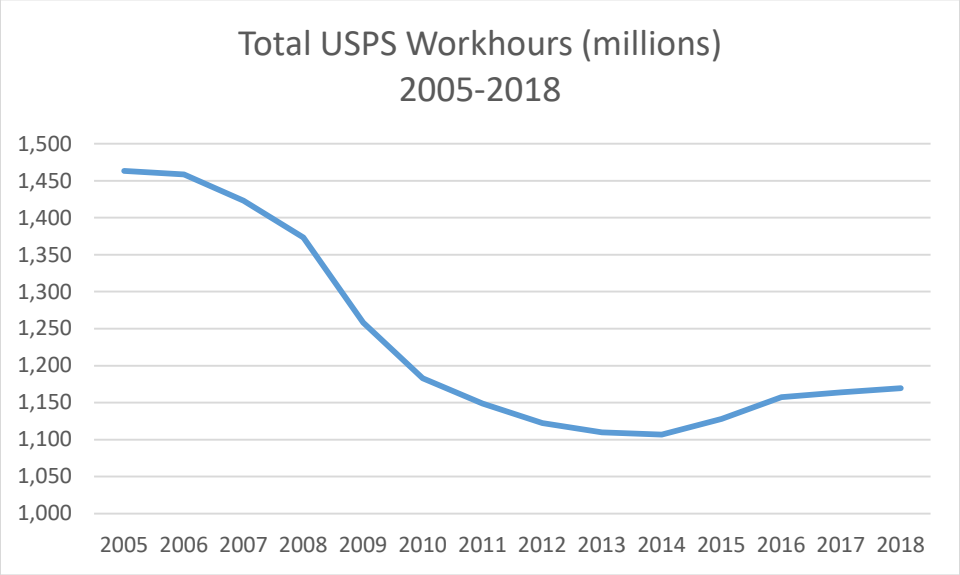
would be unfortunate if the PRC accepts this notion uncritically; that would be accommodation rather than regulation. Perhaps the PRC instead is resigned to the implied conclusion that there are too many constraints on USPS' ability to reduce costs to have a meaningful impact. If so, what changed in 2014?



The chart above shows Total Factor Productivity (TFP) performance since 2005. To smooth out year over year changes it plots the 5-year moving average of annual change in TFP. There was no recession in 2014 nor was there a sudden decline in volume, yet over the last 5 years, productivity has cratered. During that time, while overall mail volume has declined steadily and predictably, labor usage has started to increase.



From 2008 (the great recession) through 2014, the Postal Service reduced workhour usage by 250 million. Since then, despite continued volume erosion, workhours have increased by 60 million and are now at the highest usage rate since 2010. Remember, in 2015, the Postal Service reduced its service standards in expectation that operational window changes (OWC) would result in annual savings exceeding $800 million. When the OIG examined actual results, they could only verify that USPS had saved $73 million over ***two*** years; only 5.6% of projected OWC savings.

Using more to produce less is not a problem that will be solved through higher prices. In fact, ratcheting up prices faster will accelerate volume declines that the Postal Service appears increasingly unable to cope with. Commercial mailers – who are captive users of a regulated monopoly – are already being asked to pay more for less. The troubling language in the PRC press release suggests that the people responsible for managing the postal regulatory system are prepared to disregard how incentives work and expect commercial users of the Postal Service to foot an ever-increasing bill.

An Essential Dilemma

On April 2, the Senate Homeland Security and Government Affairs Committee (HSGAC) convened to consider the nominations of Ron A. Bloom and Roman Martinez IV to become Governors of the U.S. Postal Service. Both gentlemen were asked, among other things, about their perspectives on the President's Task Force Report (Report) released December 4, 2018. The report was also the subject of a March 12 HSGAC hearing.

Based on the Senators' interest and the responses of the nominees, there appears to be a consensus that the Report offers some useful recommendations on how to ensure the continued viability of the U.S. Postal Service, yet it is not at all clear what happens next. Legislation seems unlikely in the short run and there are questions about whether some of the Task Force's recommendations can be implemented through administrative or regulatory means alone.

One of the central recommendations of the Report – dividing the Postal Service's products into two categories; essential and commercial - raises several practical and policy questions that require much more thought and consideration than has been given thus far. In fact, apart from a few vague examples the categories put forth are not clearly defined.
For instance, the Report appears to draw a distinction between account statements, which today would be sent via First-Class Mail, and advertising mail which uses USPS Marketing Mail predominantly. The Task Force defines statements as "essential" without much explanation.

Conversely, advertising mail, which might be physically identical and destined to the same recipient address as a statement coming from the same sender, is considered commercial because the senders purportedly decide how much mail to send based on the return on investment (ROI) that each mail piece is expected to produce.

This distinction betrays a fundamental misunderstanding of how commercial users of the postal system make decisions. Consider a bank that sends statements to ***existing*** account holders and marketing mail to ***prospective*** account holders. Physically, those pieces are likely to be indistinguishable from one another except for the indicia that identifies which mail class is being used. In some cases, the bank might send both types of mail to the same address during the same week.
Account statements routinely contain as much marketing content as account information,

POSTAL PREVIEWS

May 22- 25 *Dublin, Ireland*
CRRI 27th Conference on Postal and Delivery Economics
Michael Plunkett Presenting

June 4-5 *Alexandria, VA*
PostCom Study Day and Board Meeting

June 5-7 *Arlington, VA*
PostalVision 2020/9.0

June 18-20 *Washington, DC*
Mailers Technical Advisory Committee

August 27-29 *Washington, DC*
Mailers Technical Advisory Committee

October 1-2 *Alexandria, VA*
PostCom Study Day and Board Meeting

October 1-3 *Amsterdam*
Post-Expo 2019

October 29-31 *Washington, DC*
Mailers Technical Advisory Committee

April 26-29, 2020 *Orlando, FL*
National Postal Forum

June 2-3, 2020 *Alexandria, VA*
PostCom Study Day and Board Meeting

October 6-7, 2020 *Alexandria, VA*
PostCom Study Day and Board Meeting

UPCOMING MEMBER EVENTS

MAY 15 3PM ET - MAY MEMBER WEBINAR

JUNE 4 - POSTCOM STUDY DAY INFORMATION AND REGISTRATION

JUNE 11 3PM ET - JUNE MEMBER WEBINAR

while marketing mail generally exhibits a degree of personalization such that novices might find it difficult to tell the difference. Today, the price difference between these two products – about 13 cents/piece – reflects differences in service levels. If marketing mail were no longer subject to a price cap, within a few years that gap would all but disappear; along with much of the mail volume which contributes to the provision of universal mail service.

In addition, mailers make ROI decisions on both categories. For instance, if the cost to mail statements were to rise substantially, mailers would provide incentives for their customers to convert to electronic statements to save postage.

If the Postal Service were suddenly granted unlimited pricing authority for marketing mail, prices would converge to the point where mailers would no longer have any reason to use marketing mail. They would seek the price cap protection still afforded to statements by shifting to First-Class Mail. Unless the Postal Service plans rigid enforcement of content restrictions on all letters, marketing mail letters might disappear altogether.

On the package side of the Postal Service's business, the situation is likely to be equally muddled. For the most part, package services are today part of the Postal Service's competitive products. The Postal Service is free to set rates and negotiate prices with customers because those products are subject to competition by rivals such as UPS and FedEx. The Task Force would make an exception for essential shipments going to rural citizens who they describe as captive users of the system.
At the March 12 hearing Senator Enzi (R-WY) suggested that one example might be winter gloves in Wyoming, but perhaps not in Florida. Would that apply to $400 ski gloves? Cashmere? Leather?

The example most commonly cited are prescription medications to rural residents. Assuming that is an appropriate policy goal, will the Postal Service have to check the contents of packages claiming eligibility for favored rates? The definition of what is considered rural is not in itself clear; many suburban areas on the outskirts of major cities are classified as rural delivery areas by the Postal Service. Would these definitions need to be reconsidered?

The Postal Service's products already include many that enjoy favorable pricing for public policy reasons such as mail sent by non-profit organizations or containing educational, cultural, or scientific content. Adding an additional policy overlay will add additional complexity without meaningfully addressing the source of the Postal Service's financial difficulties.

IN DEPTH
ANALYSIS

PRC Issues USPS FY2018 Financial Analysis

The just-released Postal Regulatory Commission (PRC) Financial Analysis of the Postal Service's Financial Results and 10-K Statement Fiscal Year 2018 paints a bleak picture of the organization's finances, with a few bright spots: a 0.1 percent increase in total factor productivity – a productivity measure that compares workload to inputs – after a slight decline in fiscal year (FY) 2017; and an improvement in liquidity, with the USPS able to pay down $1.8 billion of its $15 billion debt, the first such payment since FY 2011.

The report noted a $2.1 billion net loss from operations in FY 2018, due largely to declining Market Dominant volume and increasing operating expenses. The net operating loss was nearly $748 million more than the FY 2017 $1.3 billion operating loss. When non-operating expenses are taken into account, the FY 2018 total net loss was $3.9 billion—a decline of $1.2 billion compared with FY 2017. The PRC stated that the decline was due to a $1.8 billion increase in operating expenses and an $823 million increase in the non-cash change to workers' compensation expense, offset by a $1 billion increase in operating revenue and a combined $400 million decrease in retirement-related expenses.

The PRC took a deep dive into expenses, noting total expenses increased by $2.2 billion (3.1 percent) in FY 2018 compared with FY 2017.

Total personnel expenses for FY 2018 increased by $1.7 billion from FY 2017, largely due to increases in personnel operating expenses and a less favorable non-cash adjustment to workers' compensation liability. Compensation, retirement (service costs for the Federal Employees Retirement System (FERS)), and health benefits expenses all increased in FY 2018. The increase was despite the fact that the career workforce declined by about 6,000 employees, or 1.2 percent, while the non-career workforce declined by about 3,700 employees, or 2.6 percent. The USPS has said that over the past two fiscal years 63,000 non-career employees converted to career status to offset attrition of career employees, primarily through retirement. On the other hand, the report notes, after nine years of declining workhours since 2006, the number of workhours has been increasing over the past four years and increased by about 6 million during FY 2018. The Postal Service attributes this to an increase of 1.2 million delivery points and growth in shipping and packages volume.

Workhours by Function (Thousands of Workhours), FY 2016 – FY 2018

	FY 2018	FY 2017	% Variance FY 2018 over FY 2017	FY 2016	% Variance FY 2017 over FY 2016
Mail Processing	198,029	202,069	(2.0%)	204,403	(1.1%)
Customer Service	169,372	170,725	(0.8%)	170,377	0.2%
Delivery Service:					
City Delivery	426,353	422,811	0.8%	416,646	1.5%
Rural Delivery	204,874	197,574	3.7%	191,806	3.0%
Maintenance:					
Plant & Equipment	63,302	64,477	(1.8%)	65,946	(2.2%)
Vehicle	29,990	28,877	3.9%	28,637	0.8%
Other	77,697	77,345	0.5%	80,281	(3.7%)
Total Workhours	**1,169,617**	**1,163,878**	**0.5%**	**1,158,096**	**0.5%**

Decrease in amounts is denoted by (). Numbers may not add across due to rounding.

Source: Docket No. ACR2018, Library Reference USPS-FY18-7, December 28, 2018; Docket No. ACR2017, Responses of the United States Postal Service to Questions 1-19 of Chairman's Information Request No. 2, January 17, 2018, question 3, Excel file "ChIR.2.Q.3.LDC.Workhours - FY17.xlsx;" Docket No. ACR2016, Responses of the United States Postal Service to Questions 1-2, 4-9, 11-13, 15-19, 23, 28, and 31-33 of Chairman's Information Request No. 3, January 13, 2017, question 1, Excel file "ChIR.3.Q.1.LDC.Workhours.xlsx."

Transportation-related costs, which make up 10 percent of total costs, were another major source of increased expenses, rising by 8.6 percent in FY 2018 compared with the previous year. Highway transportation costs increased by 6.1 percent, with air transportation costs up 16.6 percent. According to the report, the USPS attributes these increases primarily to higher prices per mile on contract routes, package volume increases, a nationwide shortage of long-haul truck drivers, and an increase in the average price of diesel and jet fuel. Fuel is 3.4 percent of total operating expenses. The increases were offset slightly by a $20 million decline in international transportation costs.

Turning to products and services, the report noted that in a year-to-year comparison Market Dominant product revenue was down 2.8 percent, volume was down 2.5 percent, attributable costs were down 1.2 percent and the contribution to institutional costs was down 5.3 percent. The decline was, in part, due to the transfer of single-piece retail parcels from the Market Dominant product list to the First-Class Package Service product on the Competitive product list.

On the other hand, for FY 2018, Competitive product volume was up 11.0 percent, revenue was up 11.5 percent, attributable costs were up 11.4 percent, and the contribution to institutional cost increased by 11.6 percent. The PRC observed that Competitive products' share of total Postal Service revenue and attributable cost has increased nearly threefold since FY 2007, while their share of contribution to institutional cost has also steadily increased from just 5.2 percent in FY 2007 to 28.5 percent in FY 2018.

The Postal Service's continuing losses have led to a substantial gap between its assets and liabilities. During FY 2018, total assets decreased by $0.7 billion while total liabilities increased by $3.2 billion.

By the end of FY 2018, the USPS recorded total assets of $26.7 billion and total liabilities of $89.3 billion. Assets include current assets of cash and cash equivalents, receivables, supplies, prepayments, and non-current assets like buildings and equipment. Current liabilities are mostly missed payments to prefund the Retirement Health Benefits Fund (RHBF) and amortization of unfunded RHB obligations, defaulted payments for amortization of unfunded Civil Service Retirement System and FERS obligations, and short-term borrowing. By the end of FY 2018 the Postal Service had accrued $42.6 billion in unpaid RHB expenses.

The PRC stated that the gap between current assets and current liabilities has grown significantly since FY 2008. In FY 2018, the Postal Service had current assets of $11.6 billion and current liabilities of $69.5 billion. "If current assets are insufficient to meet its short-term liabilities the Postal Service could have problems paying its creditors in the short term," the PRC concluded.

Senators Vet BOG Candidates

Homeland Security and Governmental Affairs Committee Chairman Ron Johnson (R-WI) opened an April 2, 2019, confirmation hearing for two nominees for the U.S. Postal Service Board of Governors (BOG) by calling it "unconscionable" that there is not a quorum on the Board given the financial circumstances of the Postal Service.

He pointed to the 2006 Postal Accountability and Enhancement Act as one source of what is now "a mess" because of the requirements that the USPS prefund retiree health benefits. He noted the discussions now circle around how to recalculate that amortization.

Senator Gary Peters (D-MI) noted that the BOG will have a quorum for the first time since 2014 if the two nominees are confirmed. This would be a step forward in helping with the USPS's financial issues, he said, although he noted bipartisan postal reform legislation is critical.

BOG nominee Ron Bloom is currently the Vice Chairman of Brookfield Asset Management. He previously served as U.S. Treasury and White House advisor on automotive and manufacturing policy under President Obama, worked in investment banking conducting financial advisory and restructuring work, and in assets management. He holds a Masters of Business Administration with Distinction from Harvard University and also has worked with labor unions including Service Employees and the Steelworkers Union.

His work with the Steelworkers raised some tension during the hearing after Senator Josh Hawley (R-MO) read portions of a speech Bloom made to investors during his tenure with the union. The speech was disparaging of the free market economy. "Do you think the free market is nonsense?" Hawley asked. Bloom said that he regrets the comments and would not make them today, adding that his intention was to be provocative and to explain to his audience that the Steelworkers were capable of working in a hard-headed way. He said the result of his work was to help the union navigate dramatic changes while forging relationships with Wall Street.

Senator Tom Carper (D-DE) came to Bloom's defense, commenting that people, including senators, sometimes say inflammatory things but that Bloom's work over the years has been excellent.

Bloom Sees Network as Key Asset

In his prepared remarks and during questioning, Bloom emphasized that he sees the USPS's ubiquitous network as its greatest asset and said anything that would degrade that network should be avoided. The ability to deliver to every door six, and in some cases seven, days a week should help the Postal Service as it moves from being largely a First-Class Mail delivery service to more of an eCommerce delivery service.

Addressing the role of BOG members, Bloom said, "I believe that each Governor is responsible for contributing his or her best ideas and to work constructively with the other Governors to do our job. I expect that there will often be spirited debate – there are no easy answers for the Postal Service and a wide variety of relevant perspectives. But I am confident that if I am given the opportunity to serve, I can work with my fellow Governors to chart a positive path forward for this important American treasure."

The other nominee under consideration, Roman Martinez, followed business school at the Wharton School with 32 years as an investment banker. He was a partner at Lehman Brothers from 1978 until his retirement in 2003. Since 2004 Martinez has served on numerous corporate boards including that of Cigna Corporation. He qualifies as an "audit committee financial expert," as that term is defined by the Securities & Exchange Commission.

During questioning, Martinez suggested that it is important for postal management to have a system in place to hear from postal employees about what they think the Postal Service needs or ways that it could improve. He also thinks that it is critical to have a fully constituted BOG, with a diverse group of members with a range of expertise and experience to help the Postal Service navigate its current transitions and challenges.

Nominees React to Task Force Report

Asked by Senator James Lankford (R-OK) to react to the report of the President's task force on the Postal Service, Martinez said it did a good job of identifying the issues and appropriately underscored the importance of defining the universal service obligation (USO). He said he would like more information about what the task force intended with regard to packages and discussions of the revenue potential of the mailbox monopoly.

Bloom said the task force has several excellent points and ideas that deserve further study. But, he said, the report was necessarily just a summary and he would like to see the work behind it that lead to the task force's conclusions.

Finally, under questioning by Carper concerning discussions about re-amortizing the retiree health benefits payment structure, Martinez noted that the private-sector trend is not to provide retiree health benefits but to integrate with Medicare. He said current employees should receive what they have been promised but seemed to suggest this integration should be considered going forward.

Bloom said it is necessary to look at the situation holistically and determine what burden the Postal Service can bear, so that over time it can meet its promise without burdening the taxpayer.

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A Deeper Dive into Mail Quality Data Through Informed Visibility
Sunday, May 5th @ 10:15am
Room: 135

Using Informed Delivery to Enhance Your Next Omnichannel Campaign
Sunday, May 5th @ 1:30pm
Room: 139

Embracing the "Weird and Wonderful" Possibilities of Mail to Drive Omnichannel Success
Tuesday, May 7th @ 4:00pm
Room: 140

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Former PostCom Chairman, and MTAC Vice Chair

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– Lucie Jameson
Assistant Director, Direct Mail Marketing Program

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VP of Postal Affairs

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– Rich Domagala
Director of Postal Affairs

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– Steven W. Lopez
Chief Operating Officer

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