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The Cost Structure of the Postal Service: Facts, Trends, and Policy Implications

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Executive Summary

Over the past few years, the U.S. Postal Service has experienced one of the most tumultuous periods in its history. Total mail volume dropped 20 percent to 171 billion pieces from its peak in 2006 with unprecedented financial losses totaling $20 billion over the last four years. In 2010 alone, the Postal Service experienced its largest 1-year net loss of $8.5 billion. This paper reviews the major components of the Postal Service's cost structure in 2010 and provides insight into some of the more critical policy issues confronting the organization in the wake of new legislative requirements and record losses in volume and revenue.

In our discussion of the Postal Service's cost structure, we present 12 key points:

1. Mail delivery is labor intensive. Labor costs are 80 percent of Postal Service expenses. Saving cost is primarily about saving labor cost. Fully adjusting labor costs to decreases in volume is challenging because the Postal Service's delivery network has significant fixed costs.

2. From 2008 through 2010, workhours fell 14 percent, but increasing compensation and benefits costs resulted in total personnel costs declining by only 6 percent.

3. Since 1972, the total cost of benefits to the Postal Service has risen an astounding 448 percent above inflation, while the real amount spent on wages has declined by nearly 3 percent. This extraordinary increase in benefit costs is due to three factors: a general trend of higher benefit costs that has affected most U.S. companies, the gradual transfer of postal retiree benefit costs from the federal government to the Postal Service, and repeated overcharges for these retiree benefit costs.

4. The Postal Service had been unfairly overcharged $75 billion for the Civil Service Retirement System (CSRS) pensions and has overfunded the Federal Employees' Retirement System (FERS) by an additional $7 billion. In addition, the Postal Service's retiree health liabilities were previously exaggerated by using a 7 percent rather than a 5 percent health care inflation rate. Correcting overpayments and transferring any surplus to the retiree health fund would fully fund the Postal Service's retiree obligations and eliminate the need for further prefunding (except for normal costs as needed). Moreover, in the unlikely event that the Postal Service ceases operations, it could still utilize its available assets such as real estate to satisfy liabilities.

5. Unless the issues of overcharging and overfunding are addressed, the cost structure will spiral out of control and put the Postal Service's financial sustainability at risk.

6. Under the current flawed payment structure, retiree healthcare costs are projected to grow to $9.8 billion by 2016 ($5.8 billion for the mandated prefunding payment and $4.0 billion for retiree premiums). This amount comprises approximately 15 percent of total projected postal revenue in 2016 and further reduces the amount of discretionary spending available to Postal Service management.

7. The Postal Service has shed more than 200,000 employees over the past decade. As it continues to reduce employee numbers through attrition and reductions in force (RIFs), there is a net cost savings to the Postal Service in offering early retirement to eligible employees based on current retiree pension and benefit structure.

8. The Postal Service appears to have greatly improved its efficiency in the last decade. Workhours have declined 27 percent since 2000 — a massive drop. Total Factor Productivity (TFP), a measure of the Postal Service's operational efficiency, improved 10 percent over the same period. The measures tend to validate one another regarding increasing efficiencies.

9. The price cap structure for market dominant products is showing signs of strain. Since 2000, cumulative unit costs for three of the four market dominant mail classes (Periodicals, Standard Mail, and Package Services) have far outpaced increases in the Consumer Price Index (CPI-U). Even First-Class Mail unit costs, which have historically tracked closely with the CPI-U, are rapidly increasing as volumes decline. This is resulting both in an increasing inability to cut enough cost to enable revenue to cover expenses as well as a potential increase in the number of products that are unable to cover their costs.

10. Despite a drop in the overall number of reported postal worker–related injuries and illnesses, annual payouts for workers' compensation claims have remained relatively steady. Workers' compensation expenses, however, are based on the measurement of future liability, which is extremely sensitive to changes in economic assumptions. Lately, the estimated liability for future claims has grown significantly due primarily to changes in the assumed discount rate, and unrelated to the actual annual costs.

11. Transportation fuel costs remain vulnerable to volatilities in the energy markets. The Postal Service needs to implement fuel and contract management best practices to offset rising fuel prices.

12. A continuing freeze in capital investment, while saving the Postal Service in the short term, may paradoxically lead to higher costs in the future, as it defers projects that could potentially improve productivity, such as information technology (IT) upgrades, network rightsizing, and the purchase of energy efficient vehicles. Rightsizing the network to meet decreasing demand is vital to the future viability of the Postal Service.

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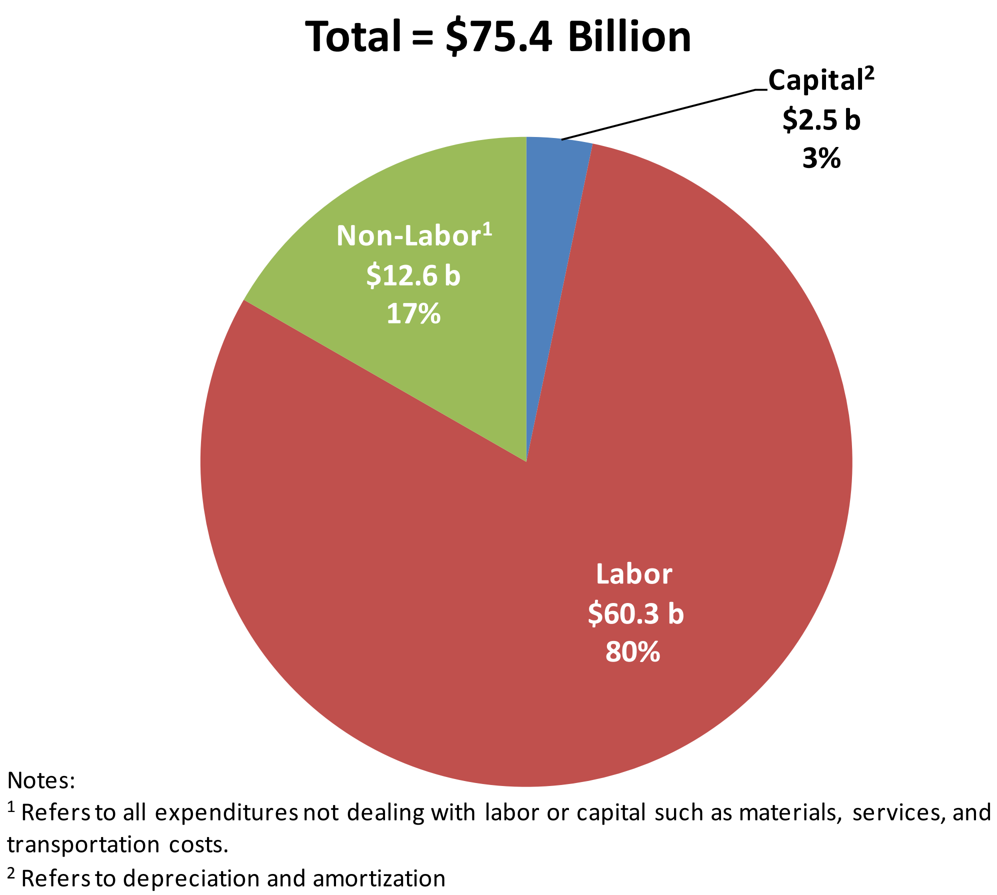
The Cost Structure of 2010

Introduction

Because the Postal Service is a network business, a large portion of its cost is fixed and does not depend on the amount of mail the Postal Service delivers each day.[1] Unlike some other network industries such as water or telecommunications, the Postal Service's last mile of service is provided not by pipes or wires, but by people. The business of delivery is a labor-intensive enterprise. As a result, the Postal Service has a relatively high proportion of labor costs. Figure 1 breaks out total operating expenses by labor, non-labor, and capital.

Figure 1: Postal Service Major Cost Categories, 2010



Source: U.S. Postal Service Annual Report 2010

[1] For example, the act of delivering four letters to an address does not cost much more than delivering one.

Fiscal Year 2010 operating expenses were $75.4 billion, compared to $71.8 billion in 2009, an increase of $3.6 billion or 5 percent.[2] Labor costs are 80 percent of Postal Service expenses. This percentage has remained relatively constant over the years despite major advances in technology and the automation of postal operations. This phenomenon is due in large part to three issues. First, there is the inherit fixity of the delivery function. Second, there is the growth in delivery points and the personnel required to deliver to the new addresses cannot be fully offset by automation. Third, postal management has been challenged to manage labor cost in reverse, meaning that retirement eligible personnel are not leaving the organization fast enough in proportion to volume losses to yield higher savings.

The other two categories include non-labor costs, which represent 17 percent of the total, while depreciation and amortization of capital costs account for the remaining 3 percent.

In reviewing labor, non-labor, and capital expenses, this paper seeks to provide the major trends and cost drivers in each category as well as present insight with implications for the ongoing policy debate about the future of the Postal Service.

Labor Costs

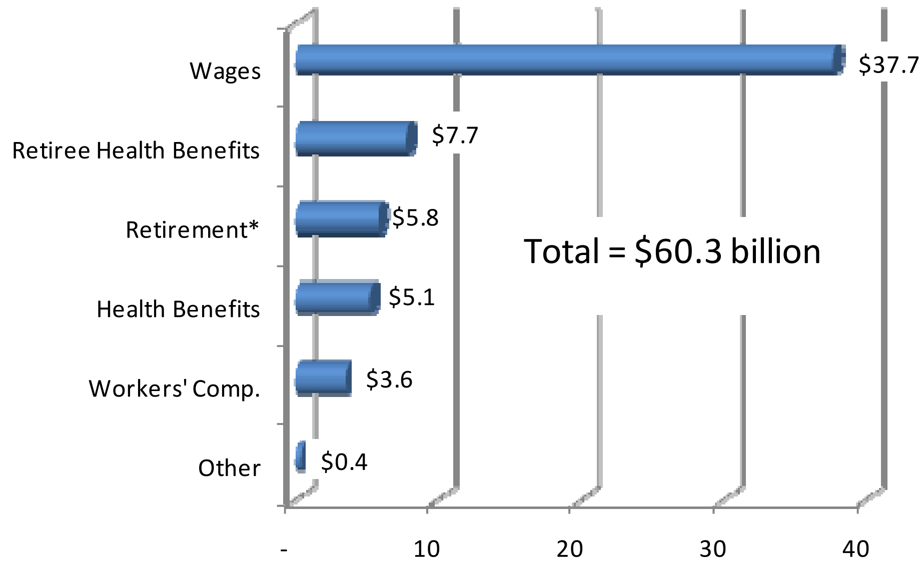
Labor costs include wages, retiree health benefits, retiree pension payments, health benefits of current employees, and workers' compensation. It should be noted that much of the expense for retiree health benefits relates to liabilities incurred in previous years and was not incurred for work done this year. In 2010, the Postal Service had 583,908 career employees, the smallest career complement in 10 years.[3] Including part-time and seasonal employees, the Postal Service had 671,687 employees in 2010 for which it spent $60.3 billion on labor costs.

In 2010, the Postal Service had 583,908 career employees, the smallest career complement in 10 years.

Figure 2 breaks out the components. Labor-related expenses have represented 80, 79, and 78 percent of total operating expenses for 2010, 2009, and 2008, respectively.[4]

[2] U.S. Postal Service, *2010 Report on Form 10K,* November 15, 2010, http://www.usps.com/financials/ar/ welcome.htm #10k, p. 13.
[3] U.S. Postal Service, *2010 Comprehensive Statement on Postal Operations*, December 2010, http://www.usps.com/strategicplanning/publications.htm, p. 41.
[4] U.S. Postal Service, *2010 Report on Form 10K,* p.16.

Figure 2: USPS Labor Costs, 2010



**This is the retirement expense for current employees. It consists primarily of Postal Service contributions to Federal Employees' Retirement System (FERS), Social Security, and the Thrift Savings Plan.*

Source: U.S. Postal Service Annual Report 2010

The largest category of labor costs is wages, making up 63 percent, while the second largest, retiree health benefits, accounts for 13 percent of total operating costs. Retirement income expenses account for another 10 percent and are comprised of contributions to Social Security and the Thrift Savings Plan (TSP) as well as payments to the Federal Employees' Retirement System (FERS).[5] The Postal Service spent $414 million on other compensation expenses including life insurance, the uniform allowance, and employees' relocation costs.[6] Benefit costs comprise 30 percent of total operating expenses.[7]

As a result of collective bargaining, Postal Service employees pay less for their health and life insurance than other federal workers. Employees on average paid for 20 percent of their premiums in 2010; this was 19 percent in 2009 and 18 percent in 2008.[8] Other federal workers pay 28 percent. As for life insurance premiums, postal workers pay nothing while other federal workers pay two-thirds of their premiums. The U.S. Government Accountability Office (GAO) found that if the Postal Service's share of life

[5] The PAEA ended regular Postal Service contributions for the Civil Service Retirement System (CSRS) and the Dual CSRS plan, because the Postal Service was fully funded. Any payments for the pensions of current employees are allocated for the FERS plan.
[6] U.S. Postal Service, *2010 Annual Report*, http://www.usps.com/financials/ar/welcome.htm, p. 44.
[7] U.S. Government Accountability Office, *High Risk Series - An Update*, Report No. GAO-11-278, February 2011, http://www.gao.gov/new.items/d11278.pdf, p. 46.
[8] Ibid, p. 21.

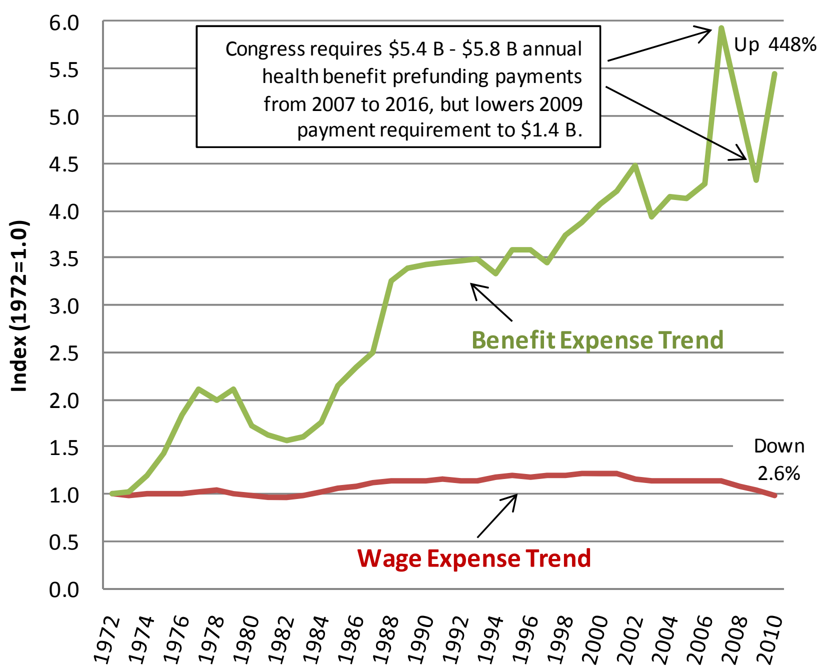
and health insurance premiums was reduced to what is paid by most federal agencies, the Postal Service would have saved about $615 million in 2009.[9]

Finally, workers' compensation expenses totaled $3.6 billion in 2010 accounting for both current payouts for claims (cash expense) and future liability (non-cash). These expenses often vary significantly from year to year because the Postal Service accounts for workers' compensation costs based on accrued estimates that are highly sensitive to changes in assumptions. Actual annual payouts for workers' compensation have been more stable, averaging around $1 billion.

Labor Cost Trends

A review of labor cost trends may provide some insight into future labor cost growth. In 1972, benefit payments were only 8 percent of total Postal Service operating expenses; by 2010, this portion has risen to 30 percent. Figure 3 shows the disparate growth in wage and benefit expenses adjusted for inflation and indexed to 1972. The total real cost of benefits to the Postal Service has increased by 448 percent over the past 39 years. The amount spent on wages in real terms declined nearly 3 percent, even as volume grew 96 percent over the same time period. That is, wages have remained relatively constant while mail volume has nearly doubled.

Figure 3: Wage and Benefit Expenses, 1972 to 2010 (Adjusted for Inflation and Indexed)



Sources: "Budget, Financial, and Operating Statistics," Budget and Financial Analysis, U.S. Postal Service and U.S. Postal Service Annual Reports 2006, 2008, 2009, 2010

[9] U.S. Government Accountability Office, *U.S. Postal Service: Strategies and Options to Facilitate Progress Toward Financial Viability,* Report No. GAO-10-455, April 12, 2010, http://www.gao.gov/new.items/d10455.pdf, p. 28.

The recent extreme fluctuations in benefits are due to the annual payments of the Postal Service into its Retiree Health Benefit Fund (RHBF) authorized from 2007 to 2016. The Postal Accountability and Enhancement Act (PAEA) directed the Postal Service to make substantial annual payments into the Postal Service RHBF over ten years, from 2007 to 2016. (Read more about this in the Retirement Costs section of this paper). To date, these payments included $5.4 billion in 2007 and $5.6 billion in 2008. In 2009, Congress, through an appropriations bill, allowed the Postal Service to pay only $1.4 billion instead of the originally required $5.4 billion payment, but in 2010, the Postal Service was required again to make a full $5.5 billion payment to the RHBF.

The large increase in benefit costs since 1972 is partly a reflection of general trends in the economy and not isolated to only the Postal Service or federal workforce. As a result of cost increases, especially for health care premiums, benefits now form a much larger share of compensation for most U.S. workers. Some of the increase in benefit expenses at the Postal Service, however, is due to Congress shifting an ever greater portion of retirement and health care costs from the federal government to the Postal Service.

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Health care costs are continuing to increase for both current employees and retirees. However, the growth in retiree premium costs is exacerbated by the increase in the pool of retirees for whom the Postal Service must pay.[10] In addition, the Postal Service is contributing to fund future retiree premiums. Though these payments are meant to secure the Postal Service's long-term financial viability by prefunding retiree health benefits, they are exceptionally large expenses in the short term; in 2010 retiree health benefits cost the Postal Service $7.7 billion ($5.5 billion for the PAEA prefunding payment and an additional $2.2 billion for health premiums for current retirees).

Premium costs are forecasted to continue increasing at a rapid pace at least in the short term. For 2011 alone, medical cost inflation is estimated at 9 percent for both the private and public sectors, far above projections for CPI growth.[11] The combination of the prefunding payment and the premium payment for current retirees is projected to reach $9.8 billion by 2016 ($5.8 billion for the prefunding payment and $4.0 billion for retiree premiums), nearly 15 percent of total postal revenue. The large, congressionally mandated prefunding payments were designed to provide a secure and healthy future for current Postal Service employees, but are ironically undermining efforts to keep the Postal Service solvent in the near term.

[10] The Postal Service pays the employers' share of Federal Employees Health Benefits Plan (FEHBP) premiums for eligible employees who retired after July 1, 1971 and their survivors. The cost is prorated based on the employee's years of service after July 1, 1971.
[11] PWC, *Behind the Numbers: Medical Cost Trends in 2011*, June 2010, http://www.pwc.com/us/en/healthindustries/publications/behind-the-numbers-medical-cost-trends-2011.jhtml.

Labor Usage

Labor expenses are also affected by the way the Postal Service utilizes labor. Table 1 shows the number of Postal Service employees by category in 2010 and 2000. Since 2000, the Postal Service has shed over 200,000 career employees (26 percent), and has experienced an 18 percent drop in volume while increasing the number of delivery points by 10 percent. The top four employee categories by size are still city carriers, clerks, rural carriers, and mail handlers, although they have switched order since 2000 as some new automation and efforts to optimize the network have further reduced the complement of clerks.

Table 1: Postal Service Employees, 2010 and 2000

Employee Category	2010	2000	Difference	Percent Change
City Carriers	192,180	241,079	-48,899	-20%
Clerks[1]	164,581	291,494	-126,913	-44%
Rural Carriers	66,845	57,111	9,734	17%
Mailhandlers	48,650	60,851	-12,201	-20%
Maintenance (all)	42,388	47,830	-5,442	-11%
Supervisors/Managers	27,792	38,797	-11,005	-28%
Postmasters, etc.	23,111	26,121	-3,010	-12%
Headquarters/Other	18,361	24,255	-5,894	-24%
Total Career	**583,908**	**787,538**	**-203,630**	**-26%**
Rural Sub/RCA, etc.	51,801	57,532	-5,731	-10%
Casual, transitional, etc.	24,628	43,745	-19,117	-44%
Postmaster Relief	11,350	12,423	-1,073	-9%
Total Non-Career	**87,779**	**113,700**	**-25,921**	**-23%**
Total	671,687	901,238	-229,551	-25%

[1]Mail Processing Clerks, Nurses, and Motor Vehicle Operators

Source: U.S. Postal Service Annual Reports 2000 and 2010

Mail volume declined some 16 percent between 2008 and 2010. During this time the total number of employees, including part-time and casuals, fell 12 percent in just the last two years, to about 672,000. Although the Postal Service's adjustment to its employee complement could be interpreted as lagging, it is continuing to implement further personnel reductions.

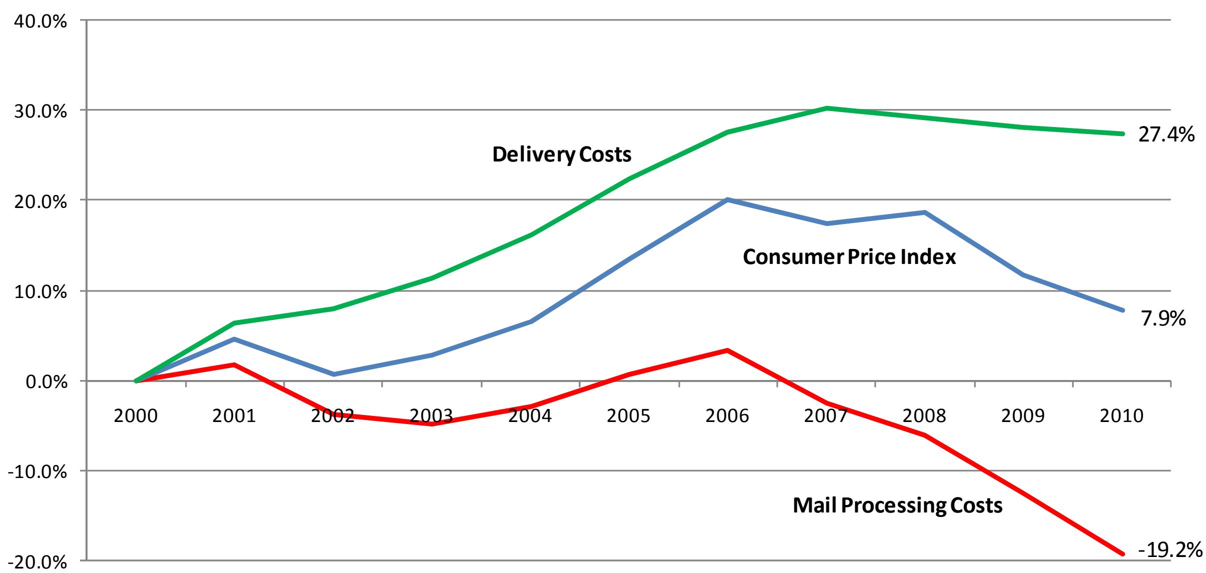
Of the $15.4 billion in labor costs for clerks and mailhandlers, mail processing accounts for the largest share: $12.1 billion.[12] Mail processing covers three major categories of activities — sortation and distribution of mail; allied operations such as collection, mail preparation, and platform operations; and, finally, miscellaneous support activities. This segment covers work in post offices, and processing and other facilities. The move from

[12] U.S. Postal Service, *Cost Segments and Components Report,* 2010, http://www.usps.com/financials/csc/welcome.htm.

manual sortation to automation and the increase in worksharing have had a significant impact on mail processing labor costs.

Figure 4 below illustrates a growing divergence between the two major labor cost categories of delivery and mail processing, challenging the core mission of the organization. On the one hand, major strides have been made in reducing mail processing costs: these have fallen 19 percent since 2000 in line with mail volume, which fell 18 percent due to continued reductions in personnel and increased automation. On the other hand, delivery, which is the largest component of labor costs, has risen by 27.4 percent during that same time period and was at $22.1 billion in 2010 due in large part to the high fixed costs associated with maintaining and expanding the network to account for new delivery points.

Figure 4: Growth of Delivery and Mail Processing Costs and Inflation, 2000 to 2010



Sources: U.S. Postal Service Cost Segments and Components Reports 2000 to 2010 and U.S. Department of Labor, Bureau of Labor Statistics website

Delivery costs are thus driving overall labor costs higher than the more modest 8 percent growth in inflation experienced between 2000 and 2010. A recent OIG report determined that as volume declines, "the mail processing, transportation, and retail functions will shrink considerably but delivery will shrink much less, leaving it larger than the other major functions combined."[13] This trend has significant strategic implications as postal management will need to place increased effort into making the delivery network as efficient as possible.

Attention is given to any idle workers in postal facilities as mail volume has been declining. This is called standby time, and occurs when workers are idled but paid due

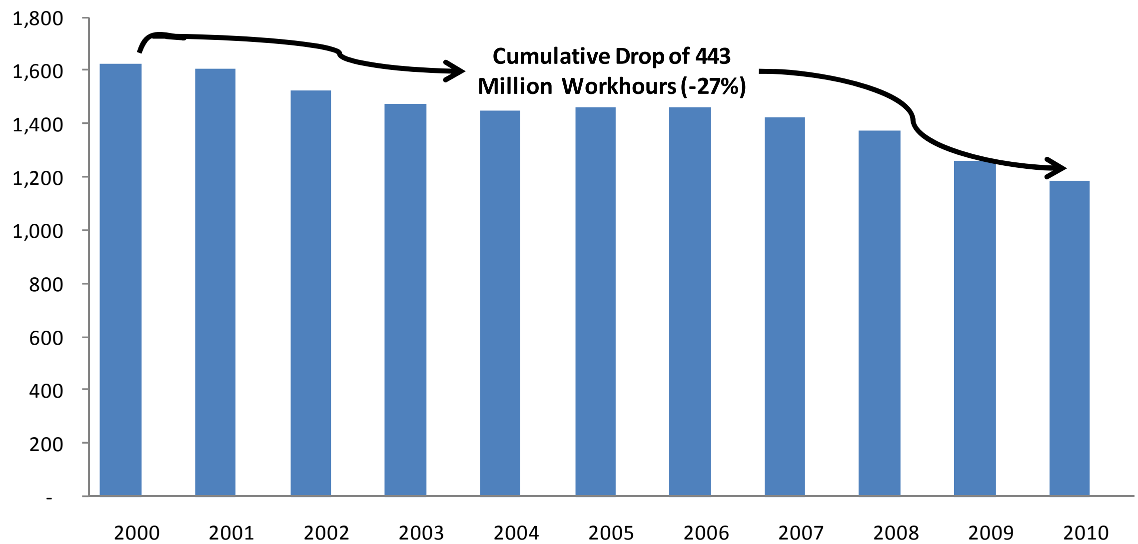
[13] U.S. Postal Service Office of Inspector General, *Implications of Declining Mail Volumes for the Financial Sustainability of the Postal Service*, Report No. RARC-WP-10-006, September 29, 2010, p. 7.

to reassignments and reorganization efforts. In September 2009, the Postal Service was averaging about 45,000 hours of standby time per week, but a year later, this was down a significant 40 percent to 27,000 per week.[14] This translates into 1.4 million workhours in 2010, which represents less than one percent of 2010's 1.18 billion workhours. Although reducing standby hours remains a top management priority, it is small relative to overall workhours and does not take away from the substantial progress made in reducing workhours.

Since 2002, workhour reductions have been the single largest savings achievement. From 2009 to 2010, total workhours decreased from 1.26 billion to 1.18 billion, or by 6 percent. Despite the addition of over 387,000 new rural delivery points, rural delivery hours decreased in 2010 due to delivery optimization initiatives and continued mail volume declines.[15] Scheduling improvements in customer service operations and improved management of routes and work schedules in city delivery contributed to saving 18 million and 16 million workhours, respectively.[16] In addition, mail processing network consolidations and improved automation resulted in workhour savings of 26.6 million workhours in mail processing in 2010.[17]

For 2011, the total workhour reduction goal is 49 million or 4 percent. If met, this achievement would help to realize the $2 billion in planned cost reductions for 2011. Figure 5 shows that this goal continues the long-term trend of declining workhours.

Figure 5: Annual Workhour Trends (millions)



Sources: U.S. Postal Service Integrated Financial Plan 2011 and U.S. Postal Service 2010 10K Report

[14] Sean Reilly, "USPS job cuts barely dent $49B payroll," *Federal Times,* December 5, 2010, http://www.federaltimes.com/article/20101205/PERSONNEL03/12050303/1001.
[15] U.S. Postal Service, *2010 Report on Form 10K,* p. 18.
[16] U.S. Postal Service, *2010 Comprehensive Statement on Postal Operations*, p. 19.
[17] U.S. Postal Service, *2010 Report on Form 10K,* p. 25.

Retirement Costs

Nearly 18 percent of the Postal Service's 2010 operating expenses were related to retirement benefits. More than half of this burden, or $7.7 billion, was for retiree health care. The PAEA of 2006, enacted when the Postal Service was in a significantly better financial position, instituted a 10-year transition from the Postal Service's pay-as-you-go health benefit funding to a system under which the Postal Service would prefund retiree health benefits. During this transition, the Postal Service pays twice: $2.2 billion in 2010 for its share of current retirees' health benefit premiums and $5.5 billion to prefund future retiree health care.

In the current environment of reduced mail volumes, these exceptional payments have contributed to large losses

The prefunding payments are extremely unusual. They are very large, fixed in law, and do not adjust to changing actuarial assumptions. Private sector companies make calculations based on actuarial assumptions and can choose whether they pay cash or just expense their obligations. The federal government does not even prefund retiree health care. In the current environment of reduced mail volumes, these exceptional payments have contributed to large losses for the Postal Service.

The Postal Service also spent $5.8 billion in 2010 on programs that provide retirement income including the FERS pension program, Social Security, and the TSP, which resembles a 401(k) program. The Postal Service no longer has to make contributions into the older federal pension program, the CSRS, because it is almost fully funded.[18]

There is a history of overcharging the Postal Service's pension programs. In 2003 and 2006, laws were enacted to remedy CSRS overpayments, but in 2010 an OIG report found that the Postal Service had again been overcharged for the CSRS pensions of employees who worked both for the Postal Service and its predecessor, the Post Office Department.[19] This time the amount was $75 billion. FERS is also overfunded and has a persistent surplus.[20] As of the end of 2009, the amount of the FERS surplus had reached $6.9 billion, yet no reduction has been made to the Postal Service's required contributions.[21] In addition, the Postal Service's retiree health liabilities were previously exaggerated by using a 7 percent rather than a 5 percent health care inflation rate.

As of the end of 2009, the amount of the FERS surplus had reached $6.9 billion, yet no reduction has been made to the Postal Service's required contributions.

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[18] The Postal Accountability and Enhancement Act of 2006 (PAEA) returned the CSRS costs of years of military service to the federal government. This change left the Postal Service's CSRS pension obligations overfunded, so the PAEA ended the Postal Service's contributions for CSRS. The $17.1 billion in excess CSRS funding as of 2006 was transferred to the RHBF. The PAEA also temporarily stopped payments for any supplemental unfunded liability through 2016. Starting in 2017, however, the Postal Service will be responsible for making amortized payments for any remaining unfunded CSRS liability. As of the end of 2009, this unfunded liability resulting from changes in assumptions and differences between assumptions and experience was calculated to be $7.3 billion.

[19] U.S. Postal Service Office of Inspector General, *The Postal Service's Share of CSRS Pension Responsibility,* Report No. RARC-WP-10-001, January 20, 2010.

[20] U.S. Postal Service Office of Inspector General, *Federal Employees Retirement System FERS Overfunding*, Report No. FT-MA-10-001, August 16, 2010.

The OIG has advocated using these overcharges to fund the Postal Service's retiree health obligations and pay down debt. If the $75 billion CSRS overcharge were added to the more than $300 billion the Postal Service has already set aside for retiree pension and health benefits, it would wipe out the Postal Service's current unfunded liability. The Postal Service need only fund the cost of the future benefits earned by employees each year (normal cost) when necessary. Additionally, the Postal Service could still utilize its available assets including its sizable real estate holdings to satisfy remaining liabilities.

Another recent OIG report advised to "reform the Postal Service's prefunding of its health and pension obligations by returning the amounts the Postal Service has overpaid and by allowing it to adopt the same funding targets commonly used in the private sector — 80 percent for pensions and 30 percent for retiree health care."[22] The Standard and Poor's companies' (S&P500) median prefunding level for pensions in 2009 was 79 percent of liabilities. The GAO reported that many experts consider at least 80 percent prefunding to be sound for government pensions. For retiree health care, the OIG determined that the average level at which Fortune 1000 companies' prefund health care is 28 percent. Utilizing this standard in the future would provide the Postal Service with a means of halting its current financial slide. During financially lucrative periods, the organization could choose to prefund at higher levels.

Issues and Policy Options

In reviewing the current cost structure of the Postal Service, three various issues related to labor costs stand out for further analysis, including problems with the current price cap used to set rates for market dominant postal products, the effect of early retirement on overall retirement costs, and the growing cost burden of workers' compensation on the Postal Service.

If the $75 billion CSRS overcharge were added to the more than $300 billion the Postal Service has already set aside for retiree pension and health benefits, it would wipe out the Postal Service's current unfunded liability.

CPI Price Cap Disconnection with Market Dominant Mail Volumes

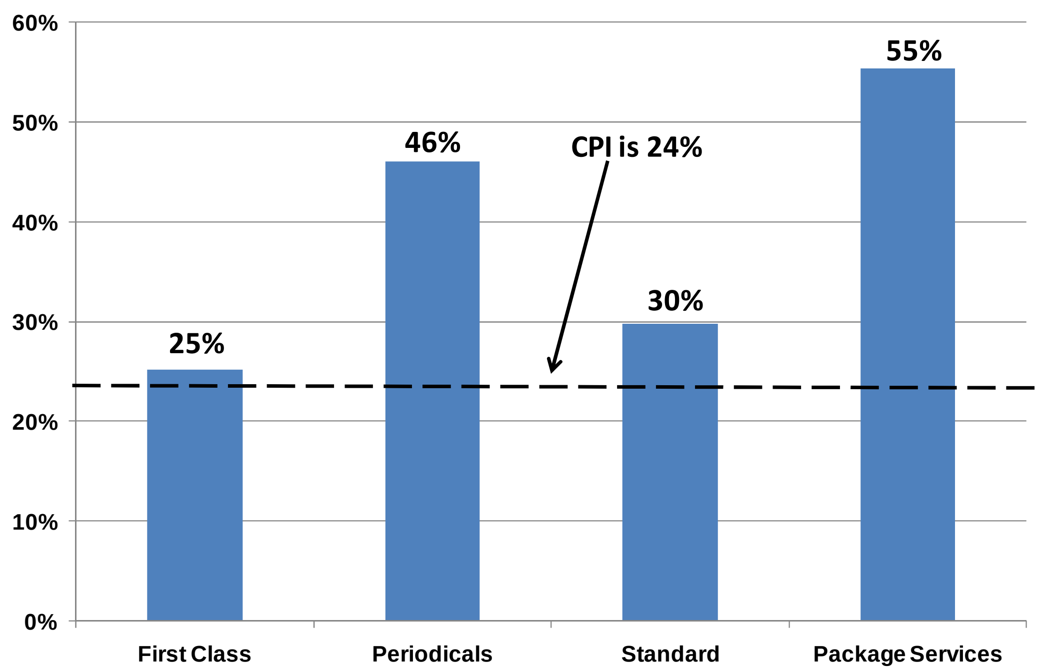
One of the most significant trends in evaluating Postal Service costs concerns the use of the price cap tied to the CPI-U for all market dominant products. The CPI-U is defined as the "measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods."[23] The CPI-U price cap is the centerpiece of the PRC's regulatory authority and was intended to be an effective mechanism for controlling Postal Service costs. The price cap received a great deal of attention in September 2010 when the Commission ruled against the Postal Service's

[21] President Obama's 2012 budget has proposed giving back the overfunded amount in amortization payments over 30 years.
[22] U.S. Postal Service Office of Inspector General, *Implications of Declining Mail Volumes for the Financial Sustainability of the Postal Service*, Report No. RARC-WP-10-006, September 29, 2010.
[23] U.S. Department of Labor, Bureau of Labor Statistics, http://www.bls.gov/cpi/cpifaq.htm#Question_1.

request for approval of an exigent rate case which would have increased rates an average of 5.6 percent across all market-dominant products.

For years, average cost increases for First-Class Mail tracked closely with increases in the CPI-U. However, the recession of 2008 to 2009, in combination with the accelerating pace of diversion to electronic communication, has undone this historical relationship with per piece costs far outpacing CPI-U growth. Even before the economic downturn, the Postal Service had difficulty in keeping costs below CPI-U for all of the market dominant mail classes with the exception of First-Class Mail (see Figure 6). When evaluating cumulative unit cost increases over the past decade as compared to inflation, all of them have increased more than CPI-U. Package Services and Periodicals, products traditionally requiring more handling, had cost increases far higher than the cumulative CPI-U increase of 24 percent while First-Class Mail unit costs average just above that percentage. This disconnection is resulting both in an increasing inability to cut enough costs to enable revenue to cover expenses while also causing additional products to fall below required cost coverage requirements.

Figure 6: Cumulative Increases in CPI-U vs. Attributable Unit Cost by Mail Class, 2000 - 2010



Sources: CPI Program at Bureau of Labor Statistics, U.S. Department of Labor, and U.S. Postal Service Cost and Revenue Analysis (CRA) Reports

One approach, highlighted in a 2010 OIG study, concluded that the Postal Service will have to raise prices above the CPI-U to break even. The report stated that the Postal Service should remain financially sustainable at least down to 100 billion pieces if it is allowed to raise prices above the CPI-U to levels that prevail in other developed countries."[24] Such an approach would require a series of significant price increases and regulatory approval given the current low prices offered on market dominant products and services compared to foreign posts in such places as Europe and Japan.

Another approach that policymakers might consider would be an expansion of the current formula used to set the cap. Instead of using solely the CPI-U index calculated by the Bureau of Labor Statistics (BLS), a more balanced approach would add an "X" factor often used in other U.S. and foreign regulated industries. This would provide an offset to account for gains in efficiency and could be deducted from any CPI increase. This would continue to apply pressure to the Postal Service to reduce costs.

The formula should also include a "Y" factor that would allow for any pass-through costs resulting from exogenous or recurring costs which could quantify inefficiencies such as the pre-funding of retiree health benefits, the provision of the Universal Service Obligation (USO), or other statutorily based programs such as the Alaska Bypass Program. The formula could also include a "Z" factor for one-time costs such as an energy crisis or a natural disaster. This overall approach would provide a sensible "quid pro quo," allowing the Postal Service to pass along cost burdens unaccounted for in the current arrangement, while allowing for offsets to account for efficiency gains and ensure that postal customers could share in the cost savings.

Effect of Early Retirements on Retirement Costs

As mail volume declines, the Postal Service has made a great effort to reduce its employee complement. This has been aided by the high number of retirement eligible employees in the postal workforce. The number of career employees has declined by more than 100,000 from 2006. In 2009, the Postal Service offered retirement incentives to certain employees, and more than 20,000 clerks and mail handlers took advantage.[25] According to the Postal Service, that early retirement offer saved the organization nearly $350 million.[26] Postal commentators have advocated for even more aggressive efforts to reduce the number of employees.[27]

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These retirements raise the question of what effect early retirement has on the Postal Service's retirement obligations. Table 2 offers some insight into this issue. It describes the effect on both current employee costs and future retirement obligations, which it is assumed the Postal Service will have to fund fully at some point. The assumption is that employees who retire early are not replaced by new employees. The effect of pension increases versus salary increases is also not considered. Employees who retire earlier typically receive a smaller annuity. However, retirees receive automatic pension increases based on inflation in retirement. If these inflation increases are greater than

[24] U.S. Postal Service Office of Inspector General, *Implications of Declining Mail Volumes for the Financial Sustainability of the Postal Service*, Report No. RARC-WP0-006, September 29, 2010.
[25] Sean Reilly, "Exclusive: Postal Service RIFs, early retirements coming soon," *Federal Times*, January 10, 2011.
[26] Ibid.
[27] Dead Tree Edition, "Here's How the Postal Service Can Get Back Its Pension and Benefits Overpayments," December 10, 2010, http://deadtreeedition.blogspot.com/2010/12/heres-how-postal-service-can-get-back.html.

the salary increases the employee would receive while working, the savings to the Postal Service from early retirement would be reduced.

Overall, offering more early retirements for eligible employees would create additional cost savings. For retiree health benefits, there would be little total savings. Generally, the Postal Service would have to pay more for FEHB premiums in retirement but it would save on premium costs for the employee. As the Postal Service pays a greater share of premium payments for employees than the rest of the federal government (discussed earlier in this paper), it would save as Postal Service retirees pay premiums according to federal rates. The problem, however, is how to incentivize further buyouts that the Postal Service cannot afford to offer in its current financial state.

Table 2: Effect of Early Retirement on Current Costs and Retirement Obligations

Area of Change	Effect on Current Costs	Effect on Retirement Obligations	Net Effect
CSRS Pension Plan	Ends current salary	Increases years covered by pension, but reduces the total pension benefit paid out for future years under pension formula	Net reduction
FERS Pension Plan			
Annuity	Ends current salary	Increases years covered by pension, but reduces the total pension benefit paid out for future years under pension formula	Net reduction
TSP	Ends TSP match	No effect	Reduction
Social Security	Ends Social Security contribution	No effect	Reduction
Retiree Health Benefits	Ends health benefit premium payments as an employee. Adds health benefit premium payments as a retiree	Increases years of health benefit premium payments as a retiree	Slight reduction in overall costs as the Postal Service pays a higher share of premiums for employees than retirees

Source: OIG Analysis

Workers' Compensation

Overall, the Postal Service allocated $3.6 billion to workers' compensation in 2010.[28] Costs associated with workers' compensation are divided into two categories for the Postal Service. The first is an operating expense that is termed a "chargeback" and is paid annually to the Department of Labor's (DOL) Office of Workers' Compensation for Postal Service employees suffering an injury or illness while on the job. The chargeback covers medical expenses, compensation for wage loss and DOL administrative fees (approximately 4 percent of the total amount) for the expenses of cases incurred during the current fiscal year. This amount has increased slightly over the past few years with the Postal Service paying DOL $1.1 billion for the cost of new cases.

[28] U.S. Postal Service, *2010 Annual Report*, p. 44.

A second and more complicated category of expenses unrelated to actual annual costs is for Postal Service liability related to the present value of the total amount the agency is expected to pay in the future for postal workers injured in that particular fiscal year. This amount is based on a complicated formula dependent upon the date of the injury, pattern of historical payments, frequency and severity of the injuries, and economic assumptions related to trends in future costs.[29]

Future costs are difficult to predict and vary quarterly based on changes in the discount and inflation rates and on the actuarial re-evaluation of existing cases. For example, a 1-percent increase in the discount rate would decrease the liability of the Postal Service by $1 billion while a decrease of 1-percent would increase liability by almost $1.3 billion.[30] As of September 30, 2010, the present value of the liability for future workers' compensation payments was estimated at $12.6 billion, an increase of some 24.2 percent from 2009. This jump was due in part to a change in the way the Postal Service measures liability. While DOL uses a simple average of 10-year Treasury note rates, the Postal Service opted to use a different standard which uses Treasury spot rates.[31]

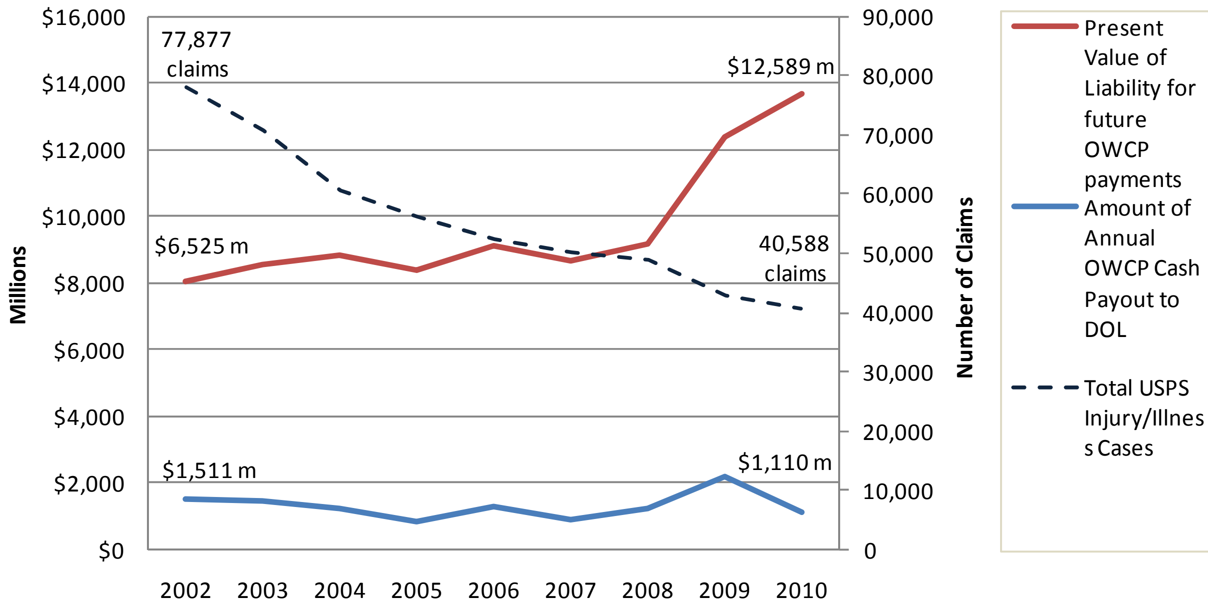
Future costs are difficult to predict and vary quarterly based on changes in the discount and inflation rates and on the actuarial re-evaluation of existing cases.

Overall, the number of injuries and illnesses reported by the Postal Service to the Occupational Safety and Health Administration (OSHA) has fallen from around 77,000 in 2002 to approximately 40,000 in 2010. However, as Figure 7 illustrates, the dollar amount of future liability for the cases which are approved by DOL is growing significantly. The Postal Service estimates that actual workers' compensation costs (annual cash payouts) will increase an average of 2 to 4 percent annually through 2020.[32] The Postal Service has stated that ever-increasing workers' compensation costs are one of three major sources of continued financial concern with the other two being declining revenue and the RHBF.[33]

Although federal agencies including the Postal Service have been working with the DOL to reduce the workers' compensation rolls across the federal workforce through private sector placements, retirements and reductions in compensation, legislative action may be necessary to reduce this growing cost burden. One possible option would be to withdraw from the DOL program and establish a separate workers' compensation program administered by the Postal Service under OWCP oversight, rather than its operational control. This would eliminate the large annual charge paid by the Postal Service annually to OWCP which is based on a percentage of the total amount paid rather than a fee per case type system. The current structure creates a moral hazard for DOL and lessens any incentive they have to reduce charges to the Postal Service.

[29] U.S. Postal Service, *2009 Annual Report,* http://www.usps.com/financials/ar/welcome.htm, p. 77.
[30] U.S. Postal Service, *2010 Annual Report,* p. 78.
[31] U.S. Postal Service Office of Inspector General, *Management Advisory – Workers' Compensation Liability Estimate* (Report Number FT-MA-11-002), p. 3.
[32] U.S. Postal Service, Action Plan for the Future, http://www.usps.com/strategicplanning/_pdf/ActionPlanfortheFuture_March2010.pdf, p. 9.
[33] U.S. Postal Service, *2010 Comprehensive Statement on Postal Operations*, p. 45.

Figure 7: Workers' Compensation Trends and Injury/Illness Cases, 2002 – 2010



Sources: U.S. Postal Service Annual Reports and Comprehensive Statements, and Dept. of Labor OSHA Federal Injury and Illness Statistics Annual Reports

Non-Labor Costs

Although the vast majority of Postal Service costs consists of compensation for employees and retirees, expenses other than labor are still significant. Notably, Postal Service management has more discretion to control these costs. As shown in Table 3, these expenses were down 3.1 percent in 2010 while mail volume was down 3.5 percent.

Table 3: Costs by Non-Labor Category, Change over Same Period Last Year (SPLY)

Non-Labor Categories	Costs by Category (Millions)				Cost Change over SPLY		
	2010	2009	2008	2007	2009 to 2010	2008 to 2009	2007 to 2008
Other	$ 1,319	$ 1,409	$ 1,506	$ 1,497	-6.4%	-6.4%	0.6%
Information Technology	$ 664	$ 722	$ 658	$ 630	-8.0%	9.7%	4.4%
Vehicle Maintenance	$ 820	$ 760	$ 926	$ 760	7.9%	-17.9%	21.8%
Building Expenses	$ 1,692	$ 1,778	$ 1,779	$ 1,700	-4.8%	-0.1%	4.6%
Supplies and Services	$ 2,236	$ 2,321	$ 2,597	$ 2,594	-3.7%	-10.6%	0.1%
Purchased Transportation	$ 5,878	$ 6,026	$ 6,961	$ 6,502	-2.5%	-13.4%	7.1%
Total Non-Labor	**$12,609**	**$13,016**	**$14,427**	**$13,683**	**-3.1%**	**-9.8%**	**5.4%**

Source: U.S. Postal Service Annual Reports 2010 and 2009

Though purchased transportation (discussed in detail below) represents 46.6 percent of non-labor expenses, this is only 7.8 percent of total costs. Non-labor expenses other than purchased transportation dropped 3.7 percent in 2010 over the same period last year (SPLY) due in large part to reductions in travel expenses and lower fuel costs.[34]

The Postal Service also incurs significant expenses for supplies and services. It pays for processing equipment supplies and maintenance, building and custodial services, advertising, and expedited mail supplies, among other such items. Overall, supplies and services decreased 3.7 percent from 2009, though advertising costs increased due to the Priority Mail Flat Rate products campaign. Spending on IT, including communications, declined 8 percent after communications upgrades were made in 2009.[35]

Additionally, the Postal Service spends nearly $2 billion on building expenses to operate and maintain its real estate inventory of more than 34,000 facilities. Annual net rental costs exceed $1 billion.[36] This expense reflects the fact that almost three-quarters of Postal Service facilities are leased.[37]

Another area showing significant cost increases in 2010 was for the organization's fleet of vehicles for delivery and local transportation. The Postal Service spent $800 million on vehicle maintenance to operate its own vehicles as well as those owned by rural carriers. The amount for vehicle maintenance service costs increased by 7.9 percent in 2010 over 2009 due primarily to increases in fuel costs, though maintenance for delivery vehicles remains high as the Postal Service extends the use of their long-life vehicles (LLVs). In 2009, the Postal Service spent $524 million to repair them. Postal management has estimated that it would cost approximately $4.2 billion to replace the entire fleet.[38]

The Postal Service estimates that it has already saved around $400 million in facility energy costs since 2006.

Facility energy consumption has recently become a major area of cost cutting as the Postal Service has set a number of goals to reduce energy, petroleum, and water use at facilities over the next 5 years.[39] The Postal Service estimates that it has already saved around $400 million in facility energy costs since 2006.[40] These cost savings are continuing due to the establishment of an ambitious set of goals to reduce overall energy use at facilities by 30 percent, petroleum use by 20 percent, and water use by 10 percent by 2015.[41]

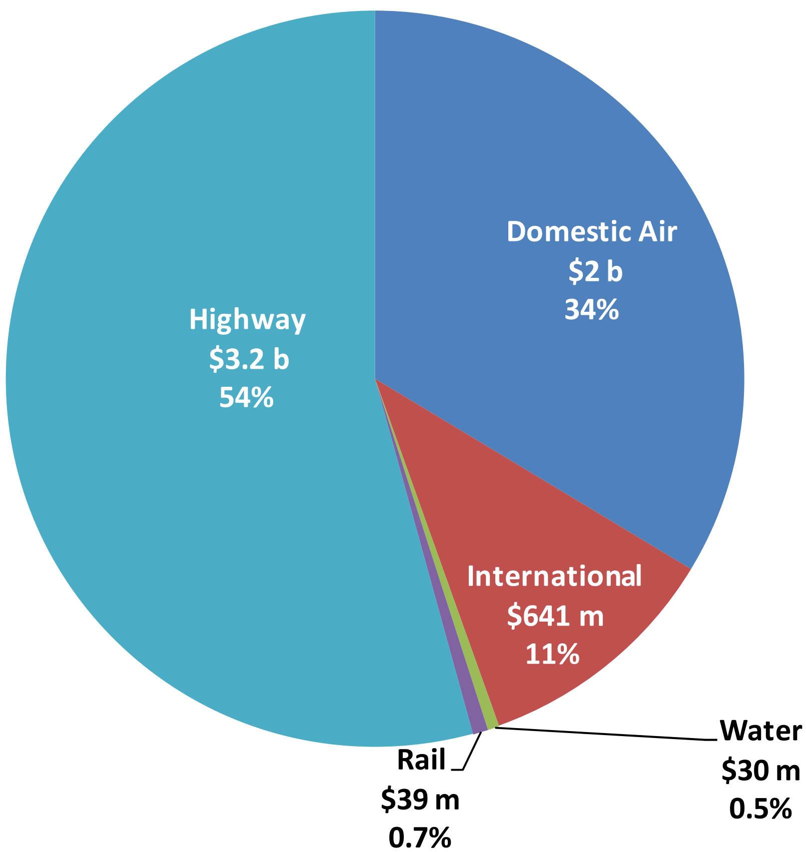
[34] U.S. Postal Service, *2010 Annual Report,* p. 52.
[35] Ibid.
[36] Ibid., p. 37.
[37] Ibid.
[38] Ed O'Keefe, "Postal service in a bind on upkeep of vehicle fleet," *The Washington Post*, June 18, 2010, p. B3.
[39] "Green Teams Help Postal Service Save Millions," January 25, 2011, http://www.usps.com/communications/newsroom/2011/pr11_008.htm.
[40] United States Postal Service, "Postal Service Moves Closer to Energy, Fuel Reduction Goals," News Release, May 11, 2010, http://www.usps.com/communications/newsroom/2010/pr10_050.htm.
[41] "Green Teams Help Postal Service Save Millions," January 25, 2011.

Purchased Transportation and Fuel Costs

The single largest Postal Service expense after compensation is purchased transportation. In 2010, the Postal Service spent $5.9 billion moving mail between cities with contracted highway, air, rail, and water transportation.

Figure 8 breaks these costs down by transportation mode. Overall, the cost of purchased transportation has decreased by $148 million, or 2.5 percent, from 2009.[42]

Figure 8: Purchased Transportation by Mode, 2010



Source: U.S. Postal Service Cost Segments and Components Report 2010

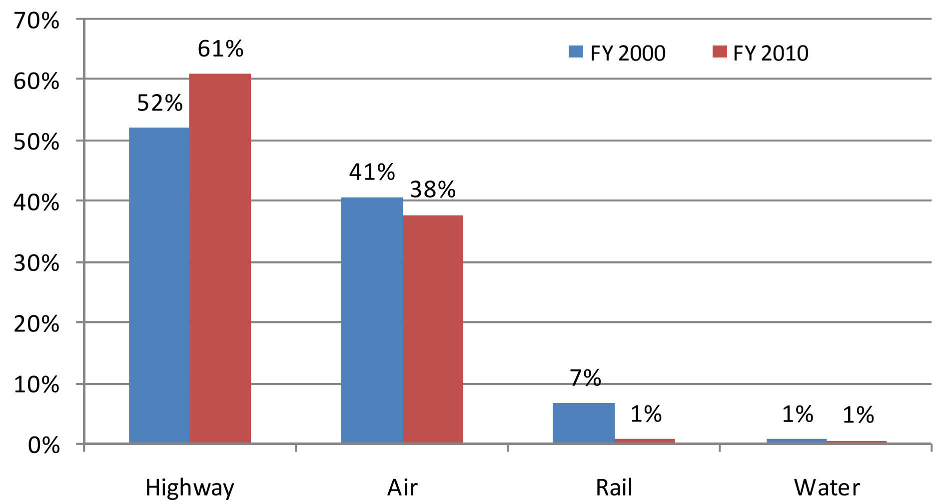
Figure 9 notes the changes in domestic transportation costs by mode over the last 10 years. There has been a significant move towards highway transportation and away from rail. Though still vulnerable to fuel shocks, highway offers the greatest control and flexibility, while offering a competitive price.

Highway Transportation expenses in 2010 were $3.2 billion, an increase of $161 million or 5.3 percent from 2009. Though volume declined 4 percent, the increase was the result of higher fuel prices and increased contractual mileage driven. Contractual miles

[42] U.S. Postal Service, *2010 Comprehensive Statement on Postal Operations*, p. 28.

driven in 2010 were 1.6 billion miles, an increase of 2.2 percent from 2009.[43] The Postal Service anticipates that the majority of the expected savings from its Network Distribution Center (NDC) implementation[44] will be realized beginning in the latter part of 2010 and continuing into 2011. However, a March 14, 2011 U.S. Postal Service OIG audit of the NDC activation impacts concluded that the effort has realized about 39 percent of projected annual savings and a 10-percent improvement in package service performance (based on available data). The shortfall occurs because the NDC initiative increased surface transportation and created unanticipated mail volume between processing facilities.[45]

Figure 9: Domestic Transportation by Mode, 2010 and 2000



Source: U.S. Postal Service Cost Segments and Components Reports 2000 and 2010

Total air transportation expenses in 2010 of $2.4 billion decreased 7.7 percent from 2009. The domestic air expense of $1.9 billion decreased 1.9 percent while international air expenses of $449 million decreased 26.6 percent. These decreases were largely driven by dropping mail volume. For domestic air, another cause of the decrease was the shift to lower-cost highway transportation created by the NDC implementation while the reduction in international air expense was driven by decreases in foreign postal transaction fees and a new competitive contract bidding system for international air carrier rates. Rail transportation expense was significantly lower in 2010, down to $39.2 million, or 55 percent. According to the Postal Service and despite recent improvements in the quality of rail service, the shift to highway transportation from rail was part of the NDC project implementation.[46]

[43] U.S. Postal Service, *2010 Report on Form 10k*, pp. 24-25.
[44] The Network Distribution Center (NDC) concept implementation began in 2009. The goal of the concept is to improve network flow through both better package distribution and transportation utilization.
[45] U.S. Postal Service Office of Inspector General, Audit Report, *Network Distribution Center Activation Impacts*, Report No. EN-AR-11-002, March 14, 2010, http://www.uspsoig.gov/foia_files/EN-AR-11-002.pdf.
[46] U.S. Postal Service, *2010 Report on Form 10K,* p. 24.

Issues and Policy Options

The volatility of fuel prices and the payment process for fuel are two areas of particular concern. The Postal Service remains vulnerable despite its massive fleet of alternative fuel-capable vehicles and the replacement of some 6,500 gasoline-powered vehicles with ethanol-capable and gasoline/electric hybrids through a GSA program. Additionally, the fuel purchase program for transportation contractors has left the Postal Service vulnerable to program misuse.

Controlling Fuel Costs

As noted already, changes in fuel prices are a primary driver in the cost of purchased transportation, and they are again on the rise in 2011. The Postal Service pays directly for contractor fuel[47] and, therefore, its transportation providers have no financial incentive to purchase the cheapest fuel available, use fuel efficient vehicles, or negotiate retail discounts. By contrast, major transportation companies typically have significant discount agreements with their retail fuel providers.

The Postal Service bears all fuel price volatility risk under its current fuel program.

The Postal Service bears all fuel price volatility risk under its current fuel program.[48] The Postal Service could dramatically improve its fuel program by simply adopting the transportation industry's standard best practices, including the revamping of the highway transportation contracting program to push fuel purchasing down to the contractors themselves and developing an adjustment mechanism tied to a fuel price index to limit Postal Service exposure to price fluctuations, Such efforts along with providing assistance and incentives towards fuel conservation could yield significant cost savings when prices rise.

Capital Investment

Capital investments, that is investments in mail processing equipment, facilities, retail support technology, infrastructure, and vehicles, are intended to support operations for a number of years and return more in savings than their costs over their useful lives. While the costs are in actual dollars, and capital spending causes changes to the Postal Service's cash position, only depreciation and amortization of the existing stock of capital show up in the Postal Service's operating expenses. Depreciation and amortization are the estimated write-off for aging Postal Service physical assets, which amounted to $2.5 billion in 2010.[49]

[47] The Postal Service provides Voyager Cards, which are similar to debit cards, to its highway contractors to purchase fuel. This program is unique in the industry for contracted transportation.
[48] U.S. Postal Service Office of Inspector General, Audit Report – Management of the Highway Contract Route Voyager Card Program, Report No. NL-AR-11-003, June 7, 2011, http://www.uspsoig.gov/foia_files/NL-AR-11-003.pdf.
[49] U.S. Postal Service, *2010 Annual Report,* p. 52.

Fiscal Year 2010 ended with 14 open projects that amount to $3.7 billion in approved capital.[50] While new capital commitments were $1.3 billion (Table 4), the Postal Service actually made cash expenditures of $1.4 billion for capital projects in 2010 (Figure 10), mostly related to the completion of commitments made in past years.[51]

As shown in Table 4, 59 percent of new commitments were for mail processing equipment, including continued deployment of the Flat Sequencing System (FSS machines), and 30 percent for building improvements, construction, and purchasing. The remaining 11 percent of the Postal Service's 2010 capital commitments was allocated for other equipment and vehicles.

Table 4: Capital Commitments, 2010

Investment Type	Amount (millions)	Share
Mail Processing Equipment	$772	58.7%
Building Improvements	$397	30.2%
Postal Support Equipment[1]	$73	5.6%
Construction and Building Purchase	$33	2.5%
Retail Equipment[2]	$33	2.5%
Vehicles	$7	0.5%
Total Capital Commitments	$1,315	100%

[1] E.g., General, administrative, automated data processing support such as servers, plotters, and high-speed copiers

[2] E.g., Lobby, window service, workstations (IRT, POS ONE), automated postal centers

Source: U.S. Postal Service Annual Report 2010

Major capital investments often take years to implement, and commitments can differ sharply from expenditures in any given year since expenditures are made incrementally to pay for past commitments.

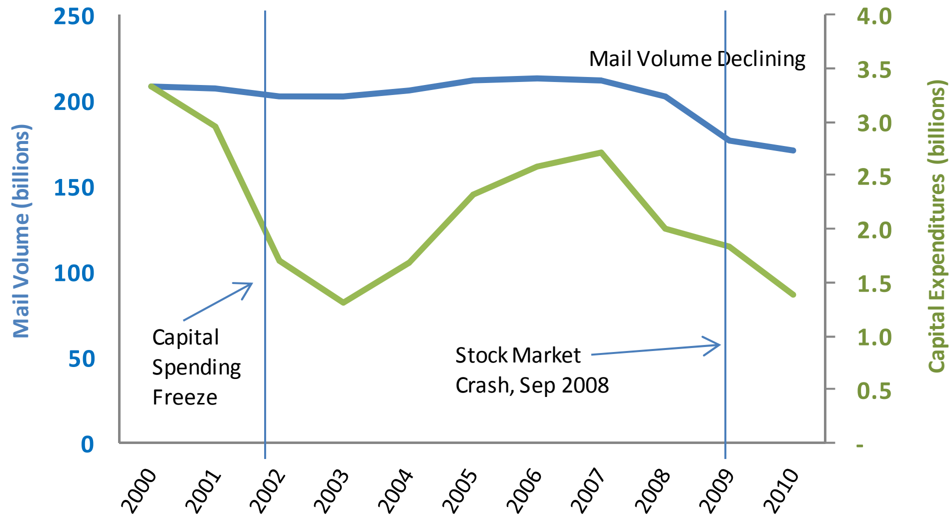
Issues and Policy Options

In 2010, the Postal Service completed 9 projects worth $1 billion in approved funding. In comparison, the Postal Service completed a total of 10 projects worth $1.6 billion in approved capital funding in 2009.[52] Capital expenditures have dropped 24 percent in 2010 during which time volumes dropped 4 percent (Figure 10). According to the Postal Service, this is a reflection of the capital spending freeze that was initiated in 2009 to limit spending to projects that are necessary for safety/health, operations maintenance and future savings, according to the Postal Service's 2010 10K report.[53] However,

[50] U.S. Postal Service, *2010 Report on Form 10K,* p. 28.
[51] U.S. Postal Service, *2010 Annual Report,* p. 2.
[52] U.S. Postal Service, *2010 Report on Form 10K,* p. 28.
[53] Ibid., p. 26, and U.S. Postal Service, *2009 Report on Form 10K,* November 16, 2009, http://www.usps.com/financials/ar/ welcome.htm #10k, p. 24.

capital expenditures have been falling since 2007 even prior to the freeze as mail volume began its decline.

Figure 10: Capital Expenditure and Mail Volume Trends, 2000 - 2010



Source: U.S. Postal Service Annual Reports 2001 to 2010

The freeze in capital expenditures raises an important question about future efficiency improvements. Traditionally, capital investments have been a major driver in the Postal Service's productivity gains over the years. If the freeze remains in effect with the focus on repairing existing facility infrastructure, will the Postal Service be able to continue making productivity gains and improving efficiency? This paradox is one that will challenge postal management as they attempt to make only the most essential investments over the coming years. UPS traditionally invests between 5 and 8 percent of its revenue into capital expenditures though it expects to temporarily lower that to about 4 percent because of the economic slowdown.[54] This greatly reduced rate would translate to an annual postal capital investment of about $3 billion.

Developing new digital applications and services and the accompanying IT infrastructure will require significant investment. The average capital commitment from 2009 to 2011 was $1.5 billion (2011 being $1.4 billion), which is far below the average of $2.4 billion or a drop of 38-percent from the previous four years. Fiscal Year 2011 commitments include $600 million for facility renovations, $400 million for new equipment, and an additional $400 million for IT and communications equipment upgrades.[55] Spending more to bring in additional revenue will remain a major challenge over the coming years.

[54] "UPS Sees Economy Gaining Steam in 2nd Half," Reuters, June 1, 2011, http://www.reuters.com/article/2011/06/01/us-ups-idUSTRE7506T920110601.
[55] U.S. Postal Service, *2011 Integrated Financial Plan*, http://www.usps.com/financials/_pdf/2011_IFP.pdf, pp. 5-6.

Conclusion

Overall, despite significant efforts by Postal Service management to reduce workhours and rein in both operating and non-operating costs over the past few years, a number of cost burdens remain beyond its control due to congressional and regulatory requirements as well as contractual obligations. From developing a more balanced price cap mechanism to determining the financial impact of early retirement to revamping the workers' compensation program, labor and, in particular, benefit costs, are growing disproportionately and at unsustainable rates. The policy options discussed in this paper are aimed at developing an understanding of the recent trends influencing labor costs. Non-labor costs and capital investments continue to pose their own challenges, including rising fuel costs, transportation contract management problems, and the capital investment conundrum of investing for critical needs in the future while facing insufficient funding for the present.

The Postal Service is at a critical juncture in its history.

The Postal Service is at a critical juncture in its history. Only through a combination of continued cost reductions including a rightsizing of the network to meet declining demand, legislative action to deal with cost burdens, and investing in select projects that continue its long history of productivity increases can the Postal Service return to economic viability.

Appendices

Appendix A: Product Cost Allocation

The Postal Service is a multiproduct firm with a shared network for distribution and delivery. The Postal Service knows how much it spends in 18 cost segments, for example carrier wages, fuel, utilities, rent, supplies, and services. If the Postal Service treated each of its products as a separate business with its own carriers and processing facilities, it would be easy to find the cost of an individual product, but it would not be an efficiently run operation. By handling different types of mail together (for example, sending one carrier to a delivery point each day), the Postal Service saves costs and leverages resources.

Costs are separated between attributable costs (volume-variable costs plus product-specific costs, e.g., the cost of advertising by product), and institutional costs using econometric analysis. Attributable costs are then distributed to products (mail classes and subclasses) using statistical sampling systems and evaluative techniques.

Table 5 below shows revenue and attributable costs broken out mostly by mail classes. The difference between revenue and attributable costs is called contribution — that is, how much that product has contributed toward institutional costs or common costs. For example, First-Class Mail generated $34 billion in revenue, but its attributable costs were only $17 billion. This means that it contributed nearly $17 billion toward common institutional costs. Its cost coverage, defined as revenue divided by volume-variable costs, was 199 percent.

Table 5: Attributable Costs, Contribution, and Cost Coverage, 2010

Mail Class	Revenue (millions) (a)	Attributable Costs (millions) (b)	Contribution to Institutional Costs (millions) (c=a-b)	Cost Coverage Percent (d=a/b)
Market Dominant	**$ 57,728**	**$ 35,253**	**$ 22,475**	**164%**
First-Class Mail	$ 34,025	$ 17,075	$ 16,950	199%
Standard Mail	$ 17,330	$ 11,818	$ 5,512	147%
Periodicals	$ 1,879	$ 2,490	$ (611)	75%
Package Services	$ 1,516	$ 1,697	$ (182)	89%
Special Services	$ 2,978	$ 2,172	$ 806	137%
Competitive	**$ 8,678**	**$ 6,257**	**$ 2,422**	**139%**
Priority Mail	$ 5,657	$ 4,247	$ 1,410	133%
Express Mail	$ 828	$ 496	$ 332	167%
Competitive International	$ 1,490	$ 979	$ 511	152%
Ground	$ 569	$ 420	$ 149	135%
Competitive Services	$ 135	$ 116	$ 19	117%
Other	**$ 669**	**N/A**	**N/A**	*N/A*
Total Mail & Services	**$ 67,076**	**$ 41,510**	**$ 25,566**	**162%**

Source: U.S. Postal Service Cost and Revenue Analysis Report 2010

Appendix B: Total Factor Productivity

The Postal Service uses Total Factor Productivity (TFP), a broad measure of operational efficiency, defined as workload executed divided by resources used. Resources include labor, capital, and materials. The TFP formula is not concerned with costs or price increases, but rather emphasizes the physical units or quantities of input and output. Table 6 shows the TFP outputs (workload) and inputs (resources) that are used to calculate the 2.2-percent TFP increase in 2010.

Table 6: USPS Total Factor Productivity 2010

TFP Workload			TFP Resources		
	Actual	Plan		Actual	Plan
Weighted Mail Volume	-5.5%	-7.0%	Labor	-5.8%	-7.9%
Miscellaneous Output	2.4%	-4.8%	Materials	-4.3%	2.4%
Delivery Points	0.7%	0.8%	Capital	-2.2%	-1.3%
Workload Growth	-3.2%	-4.6%	Resource Usage	-5.3%	-5.7%
			Total Factor Productivity	**2.2%**	**1.2%**

Source: USPS Total Factor Productivity for FY 2010

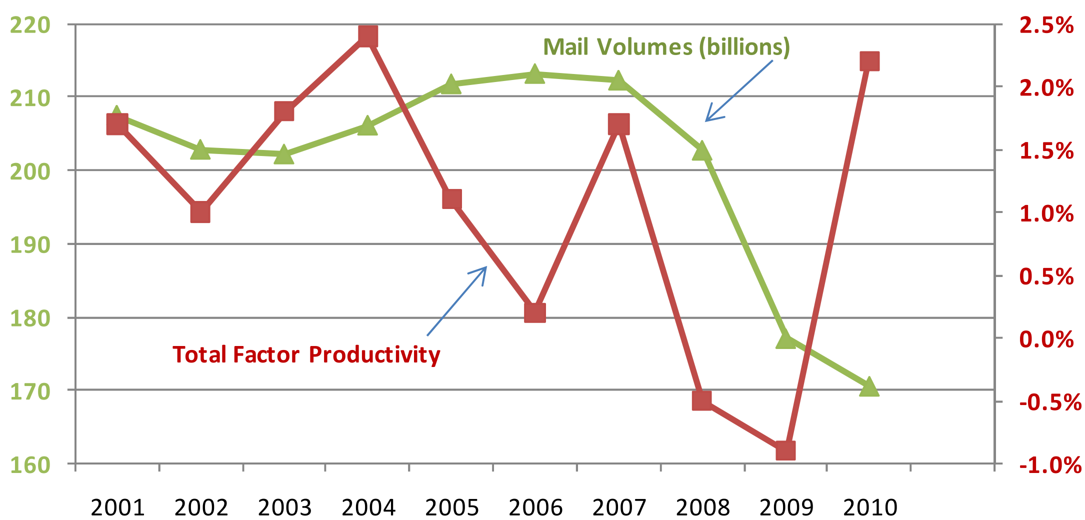
The outputs, or workload, are comprised of the mail volume and delivery points and the inputs, or resources, consist of capital, labor, and materials. Some criticize TFP for failing to include service measurement as a component. If the Postal Service reduces service to cut costs, it could improve TFP without truly becoming more efficient. Moreover, becoming more efficient does not have a predictable impact on overall financial performance. Net income also depends on the prices of inputs and the rates that the Postal Service charges for its services. TFP growth, however, does save the Postal Service money and thus creates an opportunity to improve its financial performance.

Since 1972, cumulative TFP growth is 20.3 percent.[56] Historically, increases in mail volume allowed the Postal Service to raise TFP by producing more workload with the same resources. However, beginning in 2002, there was a shift in the typical pattern when mail volume actually declined due to substitution of electronic for physical communication, yet TFP growth remained positive. According to the Postal Service, productivity gains are also the result of the efficient use of supplies and services, including transportation, and employing more automation to improve return-on-capital investments.[57] The efficiency improvements from 2000 through 2007 resulted in an average annual TFP growth rate of 1.5 percent, five times faster than during the previous 30 years.[58]

[56] U.S. Postal Service, *2010 Annual Report*, p. 53.
[57] U.S. Postal Service, *2010 Report on Form 10K,* p. 13.
[58] U.S. Postal Service, *USPS Annual Tables FY 2010 TFP*, December 7, 2010, http://www.prc.gov/prc-pages/library/detail.aspx?docketId=&docketPart=Documents&docid=72218&docType=Periodic percent20Reports/Data percent20Reports&attrID=&attrName=, Table 52.

Over the past 4 years, the Postal Service experienced a precipitous 20-percent loss of mail volume that was further exacerbated by the recession of 2008 to 2009.[59] Such a steep volume drop left the Postal Service unable to shed resources at pace with volume. As a result, the TFP growth rate fell below zero in 2008 and 2009.[60] However, in 2010 the Postal Service was again able to raise TFP by over 2 percent despite a mail volume decline of 3.5 percent. According to the Postal Service's annual report, a contributor to this reversal was a 6 percent or 70 million reduction in processing workhours due to plant consolidation, network optimization, and automation adoption. Consolidating carrier routes resulted in a 20.1 million workhour reduction in City and Rural Delivery Operations hours. Increased use of Click n' Ship, APCs, and other alternate customer access channels enhanced the customer experience while reducing 18.1 million customer service operations workhours. Lastly, a capital expenditure freeze reduced such costs by 24 percent, decreasing the quantity of capital used.[61] Figure 11 shows the history of TFP and mail volume from 2000 to 2010.

Figure 11: Total Factor Productivity and Mail Volumes 2000-2010



Source: USPS Total Factor Productivity for FY 2010

Since 2001, the Postal Service has utilized the Breakthrough Productivity Initiatives (BPI) and Lean Six Sigma (LSS) to drive reductions in TFP inputs and thus TFP growth. Over 800 continuous improvement projects have been identified, and in 2010, workhours were reduced 6 percent on average across the mail processing, customer service, delivery, and post office management components.[62]

[59] U.S. Postal Service, *2010 Annual Report,* p. 22.
[60] U.S. Postal Service, *USPS Annual Tables FY 2010 TFP*, December 7, 2010, http://www.prc.gov/prc-pages/library/detail.aspx?docketId=&docketPart=Documents&docid=72218&docType=Periodic percent20Reports/Data percent20Reports&attrID=&attrName=, Table 52.
[61] U.S. Postal Service, *2010 Annual Report,* p. 53.
[62] U.S. Postal Service, *2010 Comprehensive Statement on Postal Operations*, p. 16.