



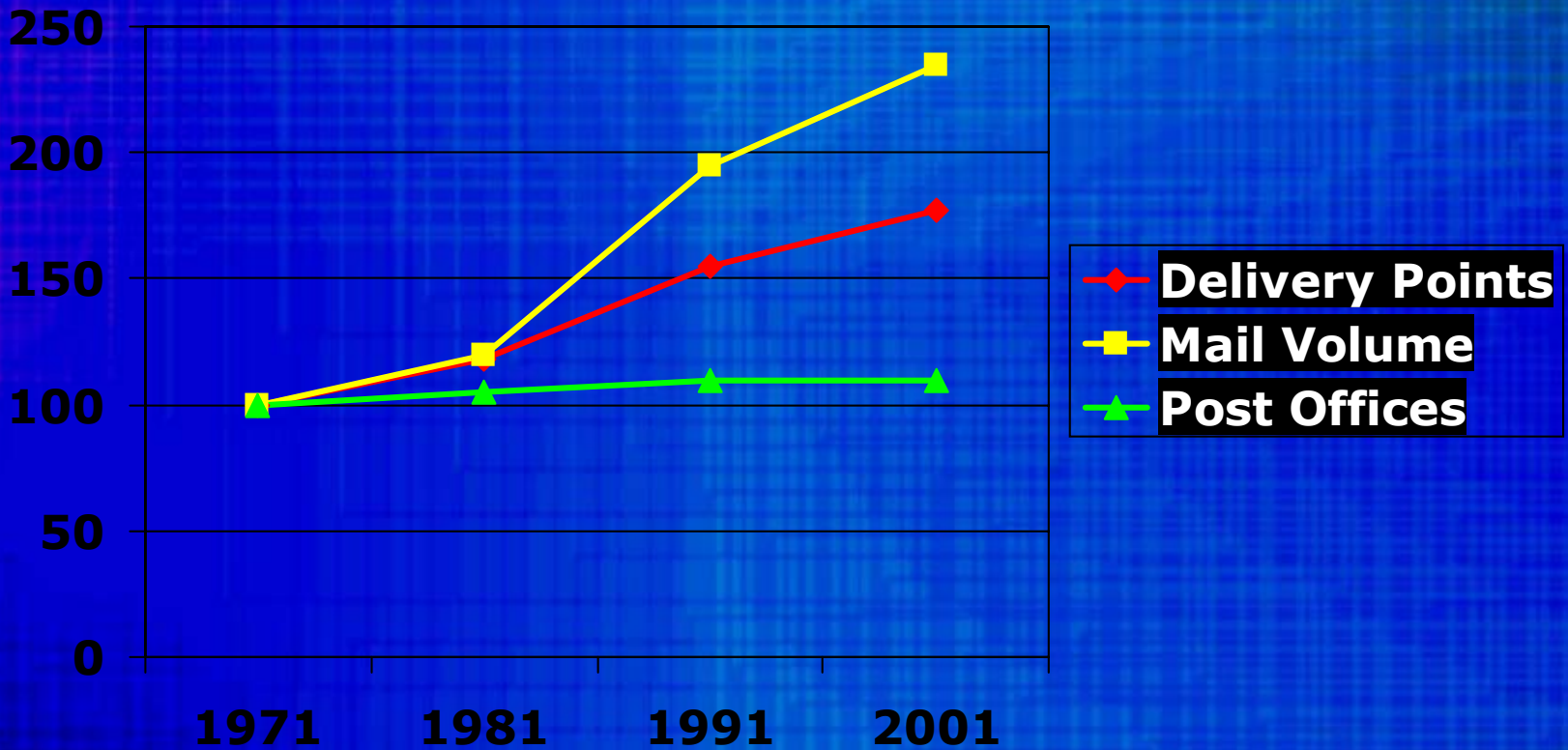
The Postal Crisis:

Fact or Fiction?



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Network and Volume History



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Outline of Workshop

- The Postal Crisis
- The USPS Transformation Plan
- Questions and Answers



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Part I: The Crisis

- The postal crisis is real, long-term and structural



2001: A Turning Point?

- First-class mail volume peak?
 - 103.7 billion, up just 1.2%
- Total volume flat: + 0.1%
 - Standard Mail, Priority Mail, Express Mail, Parcels Down
- Revenue peak?
 - Two rates increases - 6.6%; Total revenue up just 1.8%



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PFY 2002 Shocks

- Economic recession
 - Shrinking GDP; advertising depression
- September 11th
 - Mail revenue off \$1.5 billion
- Anthrax attacks
 - Mail security costs top \$1.25 billion



Post-9/11 Meltdown

- Mail volume plummets
 - **PYF 2002 is worst year since 1933**
 - First quarter: -5.4%
 - Second quarter: -3.5%
 - Third quarter: -2.7%
 - **2002 is only 7th year in last 100 years with negative mail volume**
 - 1930-1933: -33.0%
 - 1975: - 0.3%
 - 1991: - 0.9%
 - 2002: - 3.5% estimate

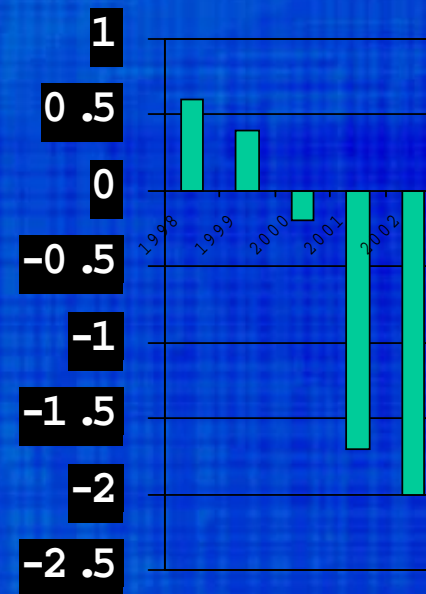


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Financial Fallout

- **Mounting Losses**
 - \$1.7 bil. in '01; an estimated \$2.0 bil. in '02
- **Three Rate Hikes**
 - Jan 2001(4.6%); July 2001(1.7%); July 2002 (7.7%)
- **New Rate Increase in 2003-04**

Net Income: 1998 - 2002 (\$ billions)



Deja Vu All Over Again?

- We've been here before . . .
 - **PRA Transition: 7-year losing streak, 1972-78, lost \$3.9 billion**
 - **OBRA Cuts: 1990-1994, \$5.7 billion in losses**
- . . . but this time it's different
 - **Volume flat in boom-time economy**
 - **Losing money despite repeated rate hikes**
 - **IT revolution**



A Crisis in the Making

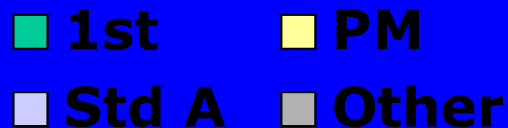
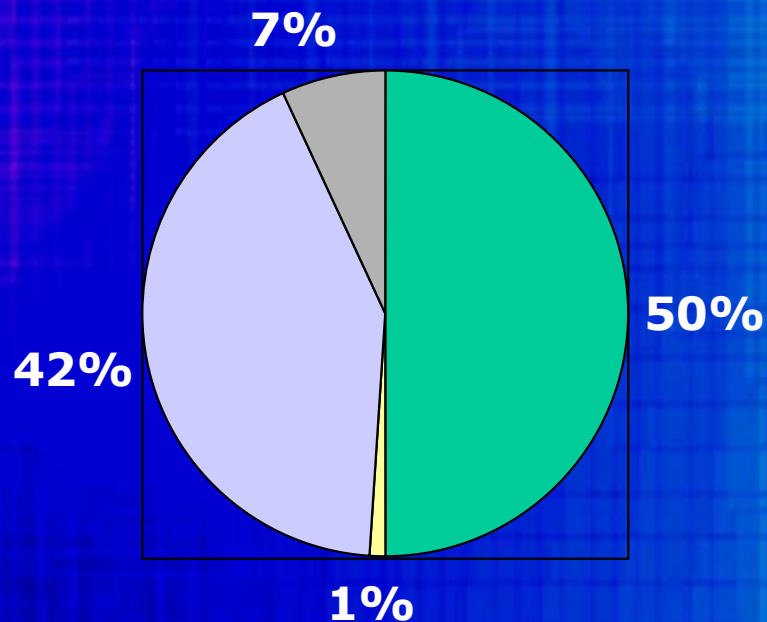
- Declining Demand for Letter Mail
- Expanding Overhead Costs
- The OBRA Legacy
- Obsolete Business Model



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Letter Mail is the Core Business of the USPS

Mail Volume: Percent of Total



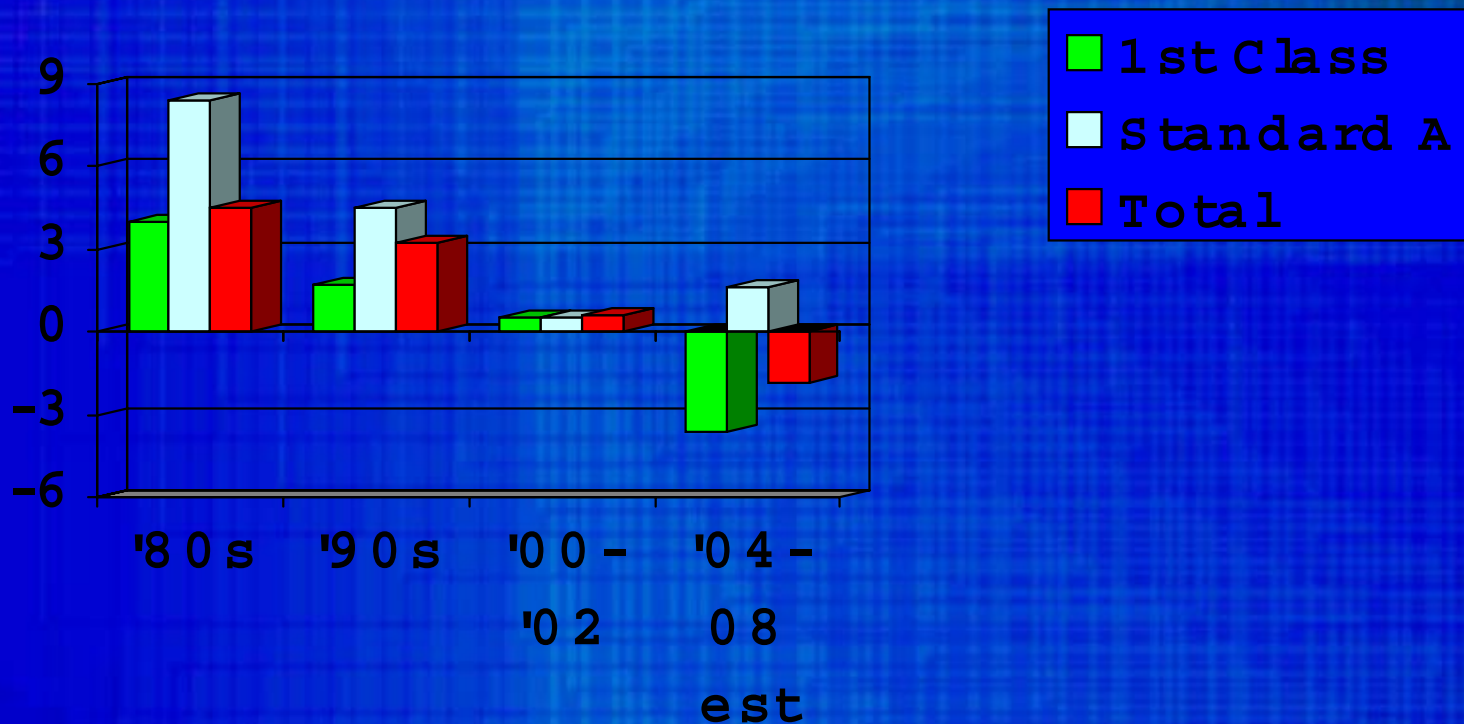
- 1st-Class generates 57% of revenue and covers 70% of system overhead
- Standard A mail makes up 42% of volume and 25% of USPS revenue



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Declining Core Business

Mail Volume - Avg Growth Rates



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Letter Mail Outlook

- GAO Forecast: First-Class start to decline 3.6%/year by 2004
 - 50 billion pieces at risk to electronic substitution (banks, credit card co., utilities)
 - Federal government points the way:
 - Congressional mail (anthrax effect)
 - FCC filings
 - USPS eBillPay and PRC procedures
- Standard A Saturation? 1.6% growth (2004-2008)



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Rising Network Costs

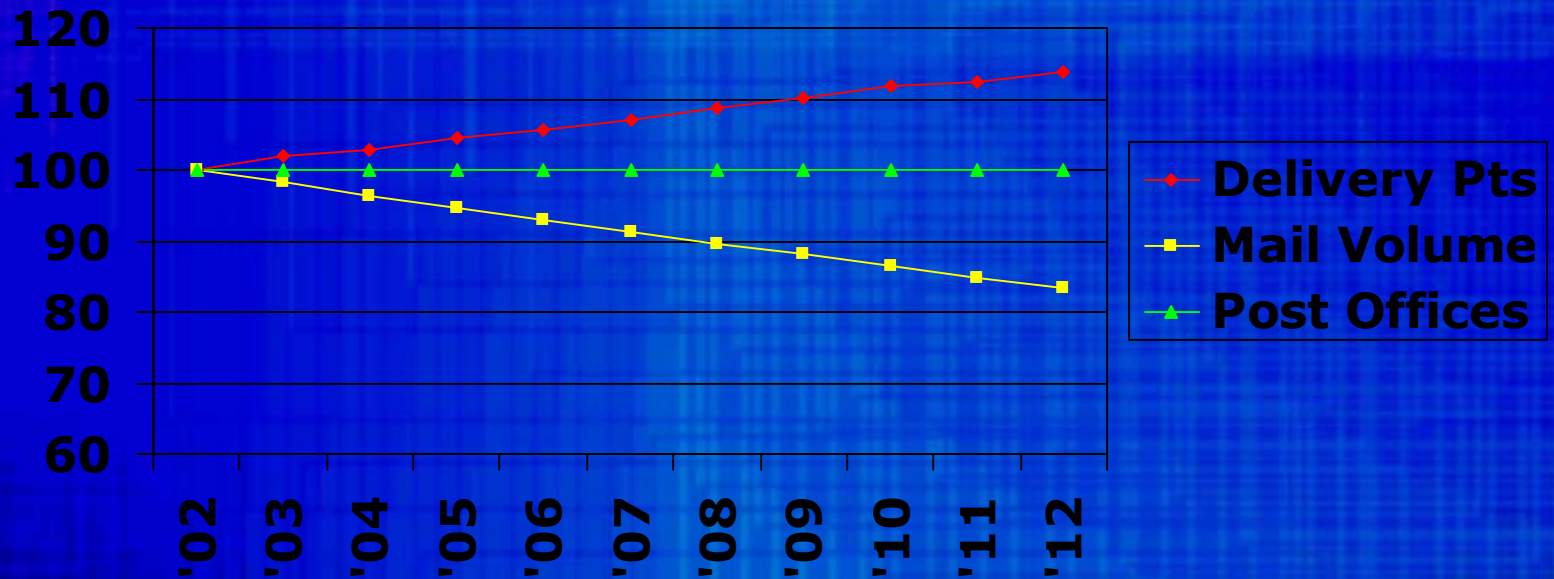
- USPS delivers daily to 135 million delivery points in U.S.
 - USPS delivery network grows by 5,600 delivery points each day
- Fixed costs: 38,000 P.O.'s & 236,000 routes
 - 80 new P.O.s needed per year (\$5 mil. each)
 - 3,400 new routes established per year



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Overwhelming Overhead?

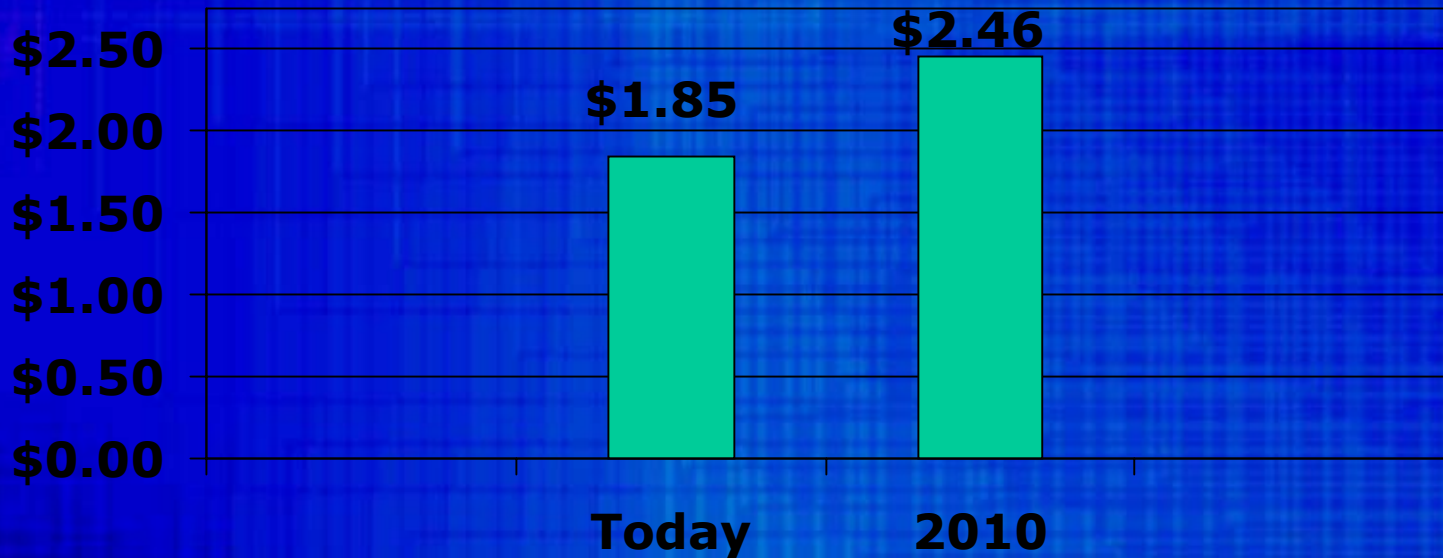
Mail Volume and Network
Projections: 2002-12 (2002 = 100)



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Break-Even Point

**Estimated Revenue Per Delivery
Needed to Break Even**



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Break-Even Point (cont'd)

- The break-even point set to rise by 33 percent
 - before any increase in labor costs
 - before impact of rate increases on volume



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Retirement Costs

- USPS is paying twice for active postal employees
 - **Deferred costs of past CSRS employees**
 - **Current costs of existing FERS/CSRS employees**
- OBRA's shift annuitant health and COLA costs to USPS



CSRS & FERS

- **CSRS - 260,000 employees**
 - USPS matches 7.0% and amortizes unfunded liability over time to cover future retirement costs related to wage increases
- **FERS - 500,000 employees**
 - USPS pays FICA taxes (7.65%) for Social Security, contributes to TSP (4-5%) and prefunds annuity benefits (12%) p



The OBRA Legacy

- What is an OBRA?
 - **Omnibus Budget Reconciliation Acts - Budget bills passed in 1980s and 1990s to reduce the federal budget deficit**
 - **Shifted tens of billions of retiree-related costs to USPS from U.S. Treasury**



OBRA Summary

■ Annuitant Health and COLA costs (\$millions)

»	<u>2001 Cost</u>	<u>1985-2002</u>
• Post-1971 retiree health – OBRA _s 1985, 1987, 1990	\$858	\$6,410
• Post-71 retiree COLA _s – OBRA _s 1987, 1989, 1990	\$814	\$8,022
• Prior-year annuitant/interest costs: – OBRA 1990, Budget Law 1993		\$3,180

USPS Retirement Cost

- Total retirement costs to rise 54% between 2001 and 2010*
- Long-term deferred retirement liability = \$32.3 billion

– *USPS estimate

- Retirement costs

- Year Cost (\$mil)

• 2001	9,085
• 2002	9,358
• 2003	9,818
• 2004	10,299
• 2005	10,864
• 2006	11,260
• 2007	11,899
• 2008	12,621
• 2009	13,274
• 2010	14,030



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USPS Retiree Health Cost

- Total FEHBP costs for retirees to rise 133% between 2001 and 2010*
- Long-term FEHBP annuitant liability = \$36.1 billion

– * USPS estimate

- Retiree FEHBP costs

• <u>Year</u>	<u>Cost (\$mil)</u>
• 2001	858
• 2002	943
• 2003	1,036
• 2004	1,138
• 2005	1,250
• 2006	1,373
• 2007	1,508
• 2008	1,657
• 2009	1,821
• 2010	2,000



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Implications

- Rising overhead and retirement costs squeezing out investment
 - USPS cutting investment in IT, new equipment
 - Freeze on new facilities
- Approaching \$15 bil. debt limit
 - Borrowing to cover operating costs
 - Outstanding debt in 2001 - \$11.3 billion
 - Likely loss in '02 is \$2.0 billion; debt crisis in '03?



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Obsolete Postal Model

- Postal Reorganization Act (PRA) limits USPS ability to pursue actions to respond to crisis
- Basic options
 - Pricing strategies
 - Expand the core business
 - Increase share of competitive postal markets
 - Generate new revenues from new products
 - Cut costs



PRA Problems-1

- Pricing Strategies
 - **Limited Ability to Raise Prices**
 - With electronic and commercial alternatives, USPS price hikes reduce volume
 - See data for 2001 -- prices up, revenue down
 - Price elasticity of postal products: A 10 percent price hike, cuts First-Class volume by 2.6% and Standard A volume by 8.1%; PM-12%; EM-16%
 - **PRC maintains excessive discounts due to political nature of rate-setting**



PRA Problems-2

- Expanding the core business
 - Law/PRC disallows targeted volume discounts, seasonal pricing, contract rates or flexible negotiated service agreements
 - Joint ventures, partnerships, outside capital investment not permitted
 - Salary cap limits executive talent



PRA Problems-3

- Ill-equipped to compete with private courier/parcel companies
 - **PRC disallows adequate reserves for investments and contingencies**
 - **Pricing restraints**
 - **Joint ventures, partnerships, outside capital investment not permitted**
 - **Private political power frames debate**



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PRA Problems-4

- **Corporate resistance to USPS entering new product markets**
 - **Perceived unfairness of government competing with the private sector**
 - **Private sector's political power to frame debate -- focus on advantages instead of cost of universal service obligations**
 - **Rate cycle drives need for quick pay-off and undermines long-term planning**

PRA Problems-5

- Cutting postal costs -- three ways:
 - **Reduce service - Redefine universal service or reduce quality**
 - **Cut rates of pay and cost of benefits**
 - **Raise USPS efficiency; productivity**
- PRA drives first two strategies and hinders third



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Part II: Postal Transformation

- Background
- Summary of Plan
- NALC Views



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Transformation: Background

- GAO Study in 2001 Put USPS on List of "At-Risk" Agencies:
 - **Facing severe financial and structural challenges that place mission at risk**
- Senate Governmental Affairs Committee requests plan



Transformation Phases

- Internal Administrative Reform
- Short-term Legislative Reform
- Long-Term Structural Reform



Internal Initiatives

- \$5 bil.cost cutting plan: So far, cut 20,000 jobs & 10,000 casuals (TWH: -4.8%)
 - 32-month plan to test and implement Flats DPS
 - L-T goal: One bundle and no carrier office time
- Discuss mediation option with unions
- Close of 500 suspended POs
- Review mail sorting network (400)
- PRC rate-making summit



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Legislative Reform

- Pricing flexibility
 - Permit NSAs, targeted discounts, phased rate increases, capital spending allowance in PRC cases,
- Facility management reform
 - Streamline P.O. network; selective reduction in frequency of delivery?
- Purchasing flexibility
 - Procurement co-ops; transport reform
- Labor/employment reform
 - Secretary of DOL mediator in postal bargaining; repeal salary cap



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Structural Reform

- **Options**

- **Privatization**

- Private ownership; deregulation

- **Subsidized Government Agency**

- Return to pre-PRA status; appropriated subsidies

- **Commercialized Government Enterprise (CGE)**

- Preferred option



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USPS CGE-Model

- Gov't owned for-profit company
 - Retained earnings used to invest in universal network
- Universal Access instead of Universal Service
 - Close loss-making P.O.s; replace with contract stations or rural carrier; Selective 5-day delivery?
- Postal related joint ventures to optimize network
 - Printers, bill processors, banks, etc.
- 'Railway Labor Act 'essential service' bargaining

NALC Views

- Support general approach: commercialization (CGE)
- Oppose RLA coverage for postal employees
- Other labor provisions
 - Guidelines for arbitrators
 - Judicial review for interest arbitration awards
 - Health and pension negotiation
- Trade-offs inevitable



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Part III: Q & A

■ Contact Information:

- Jim Sauber
- NALC Research Director
- 100 Indiana Ave., NW
- Washington, DC 20001
- 202.662.2871



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