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THE U.S. POSTAL SERVICE'S FINANCIAL CONDITION: 2018

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SUMMARY

Last year, the U.S. Postal Service (USPS) lost more than \$2 billion. This operating deficit was not a rare occurrence, as the agency has run deficits regularly over the past decade. This is because plunging mail volume has cut into its revenues. It is also \$15 billion in debt and has more than \$100 billion in unfunded pension and retiree health benefits.

USPS' financial travails are a particular problem because the Postal Service was designed to be financially self-sufficient. This means that unlike most federal agencies, it does not depend on dollars appropriated from the Treasury by the U.S. Congress. Instead, it was given a monopoly on the delivery of most types of paper-based correspondence, and in exchange, it must deliver mail six days a week to nearly every home and business in the nation.

Not all the news about the USPS's finances is bad: It currently has \$10 billion in cash and can continue operations for the foreseeable future. It has also managed to curb its cost growth by refusing to replace employees who retire. Nevertheless, the agency's continued viability as a self-funding government entity is increasingly imperiled. If the agency

cannot engineer a turn-around, Congress will need to enact reforms to avert a taxpayer bailout.

A SELF-FUNDING GOVERNMENT AGENCY

In 1971, Congress established the U.S. Postal Service as a self-supporting agency, designed to cover its operating costs by generating revenue through the sales of postage and related products and services.¹ Its annual appropriation from Congress is about \$35 million per year. This money reimburses the USPS for costs it incurs from the provision of free mailing privileges to blind persons and overseas voters.²

The USPS is often mischaracterized as a quasi-governmental or private entity.³ It is neither. It is an "independent establishment of the executive branch" that was created by Congress to achieve various public purposes.⁴ Federal law defines what products and services the Postal Service may offer, and limits much of its pricing discretion. Additionally, the USPS's workers are federal employees who participate in the Civil Service Retirement System (CSRS), the Federal Employees Retirement System (FERS) and the Federal Employees Health Benefits Program (FEHB).

Unlike typical federal agencies, however, the USPS has more freedom to order its own operations. For example, it has much greater latitude to establish and dispose of postal facilities. These authorities are essential to its mandates to "maintain an efficient system of collection, sorting, and delivery of the mail nationwide" and to be financially self-sustaining.⁵

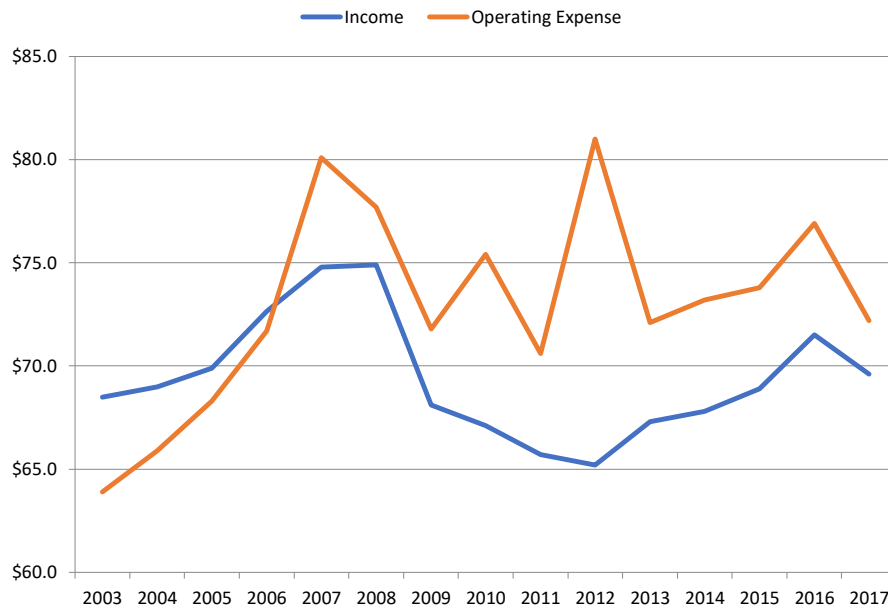
The USPS also has limited pricing discretion. The law divides its products and services into two classes: market dominant and competitive.⁶ The former is the class upon which the Postal Service has a monopoly (e.g., first class letters); the latter refers to products and services for which there are private sector providers (e.g., parcels). The USPS can raise the price of its market dominant wares by no more than the rate of inflation; its competitive products can be more flexibly priced.

PROFITABILITY: REVENUE VS. EXPENSES

The Postal Service's revenue this past year was \$69.6 billion, which is about the same as it was in 2005. On the other hand, its costs were \$72.2 billion—a net loss of \$2.6 billion. Indeed, the agency has similarly struggled to turn profits since 2006 (Figure 1).

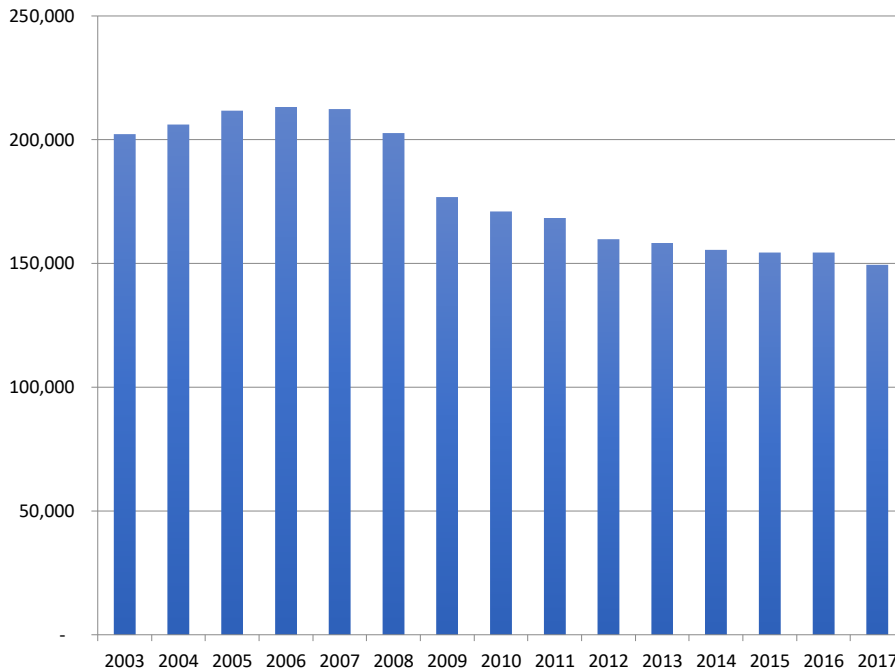
Historically, mail volume has rebounded and grown after economic downturns,⁷ but this was not case with the Great Recession, which caused a plunge in the demand to send mail—the majority of which comes from large companies.⁸ Despite the fact that the recession ended in 2009, mail volume has continued to decline (Figure 2).

FIGURE I: USPS PROFITABILITY



SOURCE: U.S. Postal Service annual reports and reports on form 10-K

FIGURE 2: USPS MAIL VOLUME



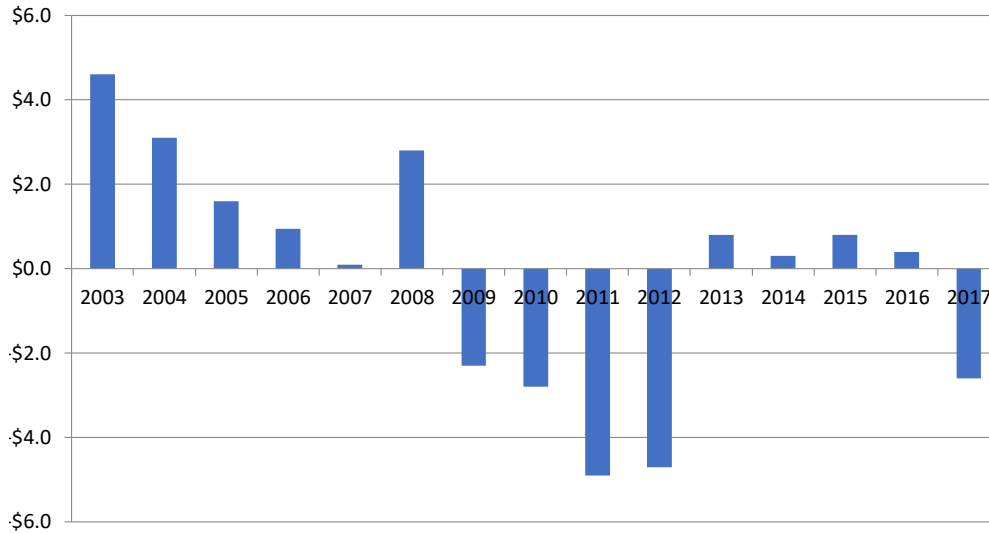
SOURCE: U.S. Postal Service annual reports and reports on form 10-K

Indeed, as shown above, there were more than 30 percent fewer mail pieces last year than there was a decade ago. And, because the USPS's revenues are almost entirely derived from mail, such reduced volume has correspondingly reduced revenue by about \$5 billion per year, as compared to 2007. Most observers attribute mail's failure to bounce back to large companies exiting the mail market. For example, many print

publications, such as magazines have gone out of business, while more and more advertisers transition their solicitations to the Internet.

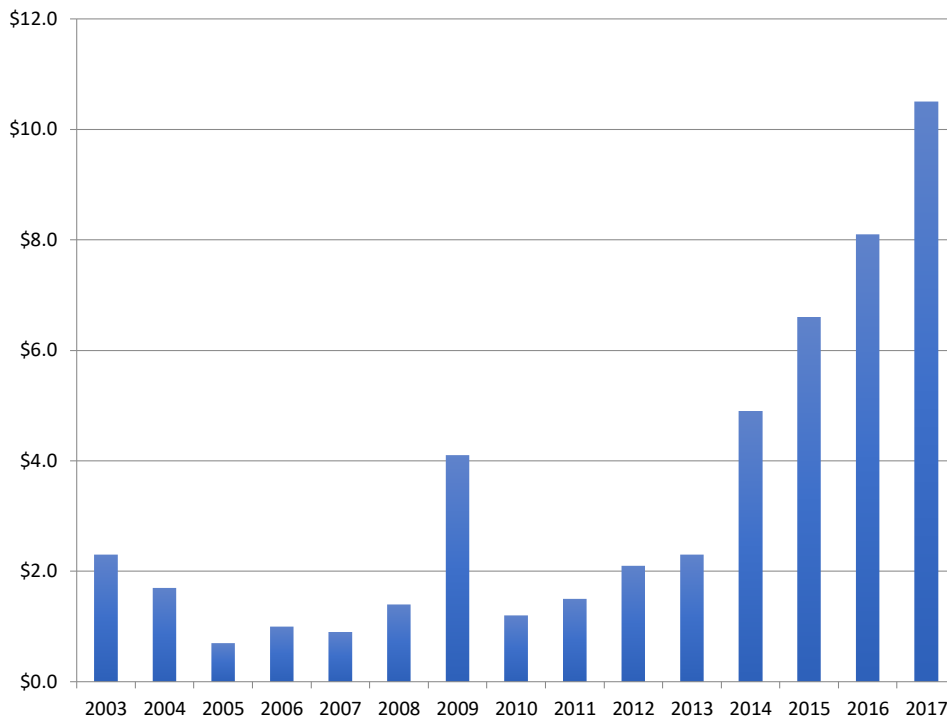
Despite this drop in revenue, however, the USPS's expenses have not followed suit. Rather, they have largely stayed the same over the past decade (although with some fluctuation).

FIGURE 3: USPS PROFITABILITY WITHOUT RETIREE HEALTH EXPENSES



SOURCE: U.S. Postal Service annual reports and reports on form 10-K

FIGURE 4: USPS LIQUIDITY



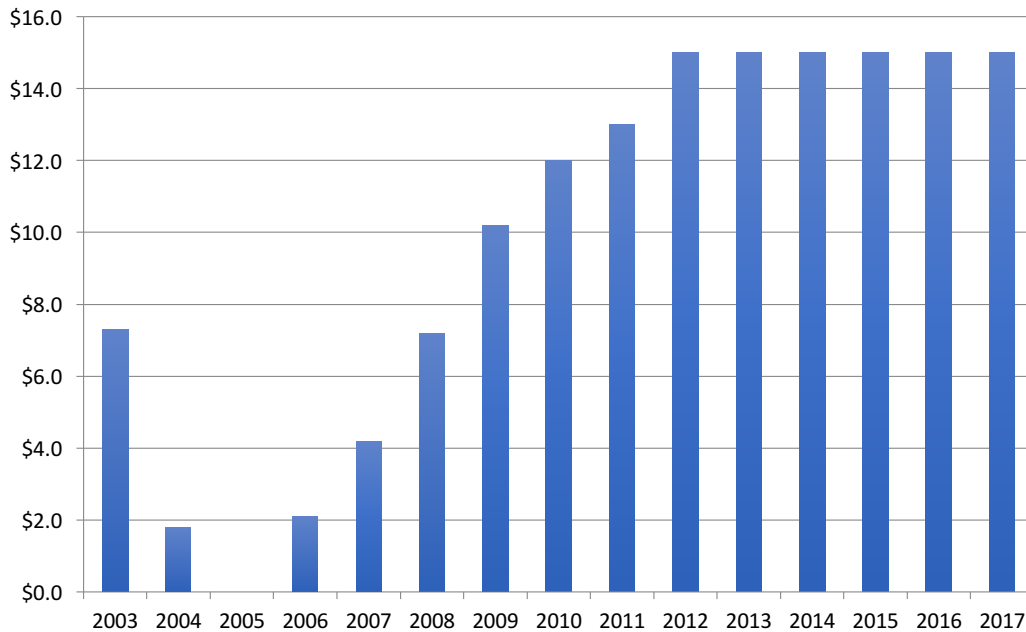
SOURCE: U.S. Postal Service annual reports and reports on form 10-K

Much of these expenses—approximately \$55.2 billion (79.3 percent) in 2017—were for salaries and benefits.⁹ For this reason, the Postal Service has refused to replace employees who retire or depart as its primary form of cost control. As a result, the agency has 300,000 fewer employees than it did a few decades ago, however, it still has 500,000 employees and 600,000 retirees who receive health and pension benefits.¹⁰

As the agency notes, the per capita costs of its employment are sticky because:

We have no control or influence over the benefits offered by [the FEHB, CSRS and the FERS] and are required to make contributions to [them] as specified by law or contractual agreements with our

FIGURE 5: USPS DEBT



SOURCE: U.S. Postal Service annual reports and reports on form 10-K

unions (in the case of health benefits for most active employees).¹¹

Additionally, the expenses the USPS booked between 2007 and 2016 were increased by the congressional mandate that it must prefund its current employees' future retirement health benefits in amounts that ranged from \$5.4 to \$5.8 billion per year.¹² Further, in the years between 2007 and 2010, the agency also paid into the Postal Service Retiree Health Benefits Fund (PSRHBF). While it did not do so from 2011 to 2016, it nevertheless had to book the amount annually obligated. When these expenses were removed, the USPS fared slightly better but was still unprofitable for five of the past ten years.¹³ Additionally concerning is that even when the USPS has been in the black in recent years, its profits were paltry—less than \$500 million per year (Figure 3).

LIQUIDITY AND DEBT

The USPS's liquidity and debt conditions sharply contrast. At the end of Fiscal Year 2017, the postal service had \$10.5 billion in cash and cash equivalents, which is more than it has possessed in at least the past 15 years.¹⁴ Indeed, a decade ago, it teetered on the brink of a liquidity crisis because it held a mere \$800 million in cash—an amount less than its weekly \$1+ billion operating expenses (Figure 4).

On the other hand, the agency's debt is at its statutory maximum at \$15 billion. In 2005, it had none, but since then, that number has ballooned based on two main factors. First, between 2007 and 2010 when it was making the payments, its

cash was sapped by the aforementioned PSRHBF prefunding requirement.¹⁵ (The agency did not pay into the PSRHBF subsequently.)¹⁶ Second, the agency's operating losses and necessary capital upgrades also stoked USPS borrowing.

As shown above, the agency could use its cash to retire more of its debt. However, apparently, it views its debt terms as sufficiently favorable to remain at its borrowing cap (Figure 5).

FINANCIAL RISK FACTORS

Additionally, the USPS has identified a slew of risks that jeopardize its capacity to cover its annual operating costs, the most significant of which are enumerated below:¹⁷

Retiree benefits liabilities. Due to its large cohort of retirees, the agency incurs significant retirement liabilities. At the end of the last fiscal year, it had 600,000 retirees.¹⁸ Congress' 2006 statutory mandate to prefund benefits greatly reduced future retiree health benefits liability.¹⁹ The PSRHBF presently has about \$41 billion, however, a substantial unfunded obligation of \$62 billion remains.²⁰

The USPS's two pension funds are in far better shape. It has funded \$285.9 billion of the \$327.9 billion obligation, which leaves an unfunded liability of \$42 billion.²¹

Union labor contracts. Federal law obliges the USPS to collectively bargain with each of the four unions who represent more than 90 percent of its workforce. When collective bargaining fails to reach an agreement, a federal arbitrator

can settle the negotiations, but at considerable cost to the USPS. For example, in 2016, a ruling awarded pay increases to 200,000 employees.²² With four unions negotiating new contracts every few years, the agency regularly faces the possibility of costly contract-related cost increases.

Federal Employee Compensation Act expenses. The USPS pays annually into a fund for the Federal Employees' Compensation Act (FECA), which compensates federal employees who are disabled or killed on the job. The agency's annual FECA payment can fluctuate greatly based upon various factors, including the number of claims it faces and the estimated costs of those claims. Between 2013 and 2014, for example, the size of the expense increased by \$1.5 billion.²³ This payment must be made each autumn, so an unexpectedly high FECA payment could require a significant cash outlay.

Fuel expenses. The USPS uses a lot of gasoline to power its fleet of more than 200,000 vehicles. Fuel was 2.9 percent (\$2 billion) of the agency's operating expense last year, so a sharp price increase could raise costs by hundreds of millions of dollars.²⁴

Vehicle fleet replacement expenses. Much of the USPS's large fleet of delivery trucks is very old and needs replacement. With 192,000 of these vehicles nearing the end of their lives, the cost will be substantial.²⁵ Such purchases are complicated further by the various political pressures that attempt to influence the agency's selection process.²⁶ Additionally, technology is changing very rapidly, and the USPS is considering the possibilities presented by the development of vehicles that are mostly autonomous.

Revenue uncertainty. As big mailers and John Q. Public alike have shifted to electronic delivery, there are simply fewer letters, postcards, marketing mail (aka junk mail) and periodicals being sent. The lone exception to this trend is parcels, the volume of which has crept upward and brought in \$19.6 billion, or 28 percent of the USPS's \$69.8 billion in revenue last year. Perhaps unsurprisingly, the Postal Service's leadership believes its survival depends upon carrying more of these parcels. However, it is competing with many private sector firms, and notes that its parcel revenue could heavily depend upon three large shippers, each of whom is developing their own transportation capacity. Were a large shipper to remove its packages from the mail stream, the USPS could lose billions in revenue.

CONCLUSION

The U.S. Postal Service was intended to be financially self-sufficient. From 1971 through 2006, this model worked decently as mail volume rose nearly every year. However, for the past decade, it has run deficits frequently and its profitable years were only just. Mail volume shows no signs of

growing, despite a surge in the number of parcels shipped last year.

Nevertheless, thus far, the Postal Service has endured. Its sizable cash holdings ensure—at least in the immediate future—that it will not face a liquidity crisis that forces it to close operations, or to be bailed out by taxpayers.

However, such silver linings only temporarily obscure a very dark cloud. The apparently permanent, large drop in demand for the USPS's products and services presents a fundamental business challenge. Additionally, the agency is threatened by several other financial perils that can weaken its cash position. Finally, the fact that it bets its continued viability on parcels when various private sector firms already provide parcel delivery is concerning, particularly coupled with the reality that at any time, major retailers could quit using its services.

The USPS may not be presently teetering on the edge of a financial crisis, but its viability as a self-funding entity is uncertain, at best. And if the agency is unable to adapt, Congress will need to step in to avert a public bailout.

ABOUT THE AUTHOR

Kevin R. Kosar is vice president of policy for the R Street Institute, where he oversees all of its research across its commercial freedom, criminal justice, energy and environment, financial markets, governance, income mobility, innovation policy, insurance and public health policy programs. He co-directs the nonpartisan Legislative Branch Capacity Working Group, which aims to strengthen Congress. Kevin joined R Street in October 2014 from the Congressional Research Service, where he served as an analyst and research manager. Earlier in his career, he was a lecturer in policy and public administration at New York University and Metropolitan College of New York. Kevin is the author of three books: *Failing Grades: The Federal Politics of Education*, published in 2005; *Whiskey: A Global History*, published in 2010; and *Moonshine: A Global History*, published in 2017. He has been a Presidential Management Fellow and won the Academy of Wine Communications' wine writer award. Kevin received his doctorate in politics from New York University and his bachelor's from Ohio State University. He lives in Washington.

ENDNOTES

1. Before 1971, it had been heavily dependent on annual appropriations.
2. *Financial Services and General Government (FSGG) Appropriations, FY2018*, Congressional Research Service, Sept. 1, 2017, p. 3. https://www.everycrsreport.com/files/20170901_R44933_955d403119acb3ab4b3d593d93dcd8538f58fce5.pdf.
3. "Mismanagement drives losses at postal service," *Bowling Green Daily News*, Jan. 8, 2018. http://www.bgdailynews.com/opinion/commentary/mismanagement-drives-losses-at-postal-service/article_19e219db-f365-57cb-9cff-1ad2b2160dde.html.
4. "About: United States Postal Service," U.S. Postal Service, 2018. https://about.usps.com/publications/pub100/pub100_036.htm.
5. 39 U.S.C. §403(b)(1)
6. 39 U.S.C. §§ 3621 to 3642
7. Written testimony of Kevin R. Kosar, House of Representatives, Committee on Oversight and Government Reform and the Subcommittee on Federal Workforce,

Postal Service, and the District of Columbia, "Continuing to Deliver: An Examination of the Postal Service's Current Financial Crisis and Its Future Viability," 111th Congress, April 15, 2010, p. 12. <https://oversight.house.gov/wp-content/uploads/2012/02/20100415Kosar.pdf>.

8. Person-to-person correspondence amounts to perhaps 9 percent of the total mail volume. Author calculation based upon data (13.9 billion and 154.1 billion) from John Mazzone and Samie Rehman "The Household Diary Study Mail Use & Attitudes in FY2015," U.S. Postal Service, May 2016, p. 2. https://www.prc.gov/docs/96/96795/Household%20Diary%202015_2.pdf; and "FY2015 Annual Report to Congress," U.S. Postal Service, 2015, p. 24. <http://about.usps.com/who-we-are/financials/annual-reports/fy2015.pdf>.

9. "2017 Report on Form 10-K," U.S. Postal Service, Nov. 14, 2017, p. 14. <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

10. *Ibid.*, p. 11.

11. *Ibid.*

12. 5 U.S.C §8909(d)(3)(A). See also, *U.S. Postal Service Retiree Health Benefits and Pension Funding Issues*, Congressional Research Service, Jan. 7, 2015, pp. 2-8. https://www.everycrsreport.com/files/20150107_R43349_e37b15801b4244ca40f5d01cb-19ca07f0d59a7a3.pdf.

13. This exercise in PSRHBF accountancy should not be understood to argue that the postal service should not account for its health benefits promises to current employees, or to prefund them. Prefunding pension benefits is an age-old practice, and it is prudent for the self-funding agency to do the same for health benefits owed to retirees.

14. "FY2017 Annual Report to Congress," U.S. Postal Service, 2017, p. 6. <https://about.usps.com/who-we-are/financials/annual-reports/fy2017.pdf>.

15. *U.S. Postal Service Retiree Health Benefits and Pension Funding Issues*, p. 3. https://www.everycrsreport.com/files/20150107_R43349_e37b15801b4244ca40f5d01cb-19ca07f0d59a7a3.pdf.

16. "As of September 30, 2017, we have contributed \$20.9 billion to the PSRHBF and defaulted on additional prefunding amounts totaling \$33.9 billion for the years 2012 through 2016, because we did not have sufficient funds to make the funding payments without adversely impacting our ability to continue operations. As of the date of this report, we have not incurred any penalties or negative financial consequences as a result of not making the PSRHBF prefunding payments." See "2017 Report on Form 10-K," p. 5. <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

17. Data drawn from *Ibid.*, pp. 6-12.

18. *Ibid.*, p. 11.

19. The legislation seeded the PSRHBF with a total of \$23 billion--\$20 billion for the CSRS pension fund and a USPS escrow fund of \$3 billion. See, e.g., Office of the Inspector General, "Postal Service Retiree Funds Investment Strategies," U.S. Postal Service, September 2017, p. 6. <https://www.uspsoidg.gov/sites/default/files/document-library-files/2017/FT-WP-17-001.pdf>.

20. "2017 Report on Form 10-K," p. 11. <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

21. *Ibid.*, p. 28.

22. Eric Katz, "New 40-Month Contract Gives Nearly 200,000 USPS Employees 3.8 Percent Raise," Government Executive, July 11, 2016. <http://www.govexec.com/pay-benefits/2016/07/new-40-month-contract-gives-nearly-200000-usps-employees-38-percent-raise/129794>.

23. "2015 Report on Form 10-K," U.S. Postal Service, 2015, p. 28. <http://about.usps.com/who-we-are/financials/10k-reports/fy2015.pdf>.

24. "2017 Report on Form 10-K," p. 10. <http://about.usps.com/who-we-are/financials/10k-reports/fy2017.pdf>.

25. Office of the Inspector General, "Benchmarking of Delivery Fleet Replacement Strategies, Management Advisory," U.S. Postal Service, Report no. DRA-MA-15-002, Aug. 18, 2015. <https://www.uspsoidg.gov/sites/default/files/document-library-files/2015/dr-ma-15-002.pdf>.

26. Advocates have pressed for the USPS to move to an all-electric fleet, to lease rather than purchase trucks, and have advocated for the models of particular manufacturers. See, e.g., Sean Szymkowski, "U.S. Postal Service urged to choose electric delivery trucks," Green Car Reports, Nov. 26, 2017. https://www.greencarreports.com/news/1113964_u-s-postal-service-urged-to-choose-electric-delivery-trucks; and Justin Sykes, "USPS's Latest Billion Dollar Boondoggle," Americans for Tax Reform, Jan. 6, 2016. <https://www.atr.org/usps-latest-billion-dollar-boondoggle>.