An Alternative Approach to Ratemaking for USPS Market Dominant Mail

Working Paper

June 2024

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EXECUTIVE SUMMARY

The Postal Accountability and Enhancement Act of 2006 (PAEA) designated the USPS as an independent agency, changed ratemaking from a cost-of-service model to a price-cap system, and abolished the breakeven requirement. In 2021, after 15 years of net losses, the USPS introduced its *Delivering for America* (DFA) strategic plan to resolve its financial issues. However, the Plan has proven to be ineffective. The ratemaking approach implemented to increase revenue is taking a toll on long-run financial stability. Instead of relying on unpredictable rate increases that exceed CPI twice per year, the USPS must address a combination of productivity issues and regulatory barriers that curb its current ability to break even. If the USPS does not correct its course, it will be forced to address severe budget shortfalls through government subsidies, substantial layoffs, reduced service via fewer delivery days, or facility closures.

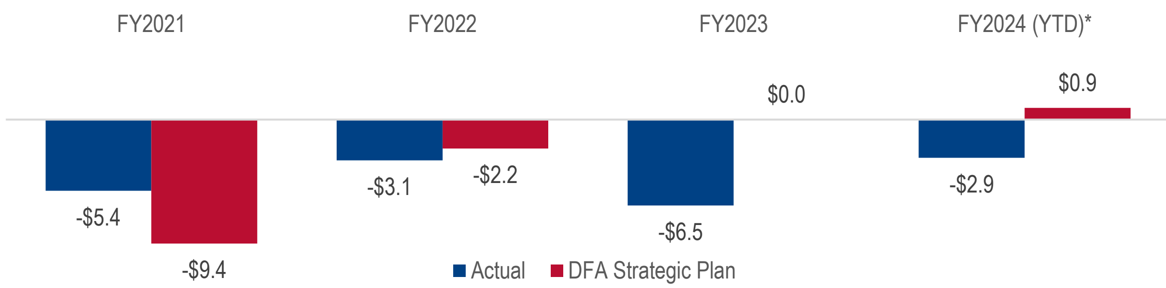
The key findings of this study are below.

1. **The financial challenges faced by USPS are longstanding.** The passage of PAEA in 2006 was intended to modernize the Postal Service. However, since then, the organization has been unable to generate positive net income.
2. ***Delivering for America* was introduced to turn the tide, but it has failed to do so.** In 2021, the USPS introduced a new strategic plan which outlined a path to financial stability by FY2023. The Plan relies on increased ratemaking authority, cost improvements, and legislative and regulatory reform. To date, it has not achieved its goal. Instead of breaking even in FY2023, USPS posted a $6.5 billion net loss (excluding workers' compensation, which was not projected in DFA). Service performance has eroded, and the new ratemaking regime has coincided with steep volume declines.
3. **An alternative plan is needed**. Currently, USPS market dominant customers are paying higher rates for worse service. USPS customers should not bear rising costs without improvements in USPS productivity, cost management, and common-sense regulatory reform. Even the Postal Regulatory Commission has raised concerns about the current strategy, noting that the proposed July 2024 rate increases, now approved, are not prudent.
4. **Ratemaking must balance cost savings with revenue-generating initiatives**. With cost containment and regulatory reforms to correct unfair and unreasonable limitations imposed on retirement programs and asset valuation, financial stability is achievable under predictable and moderate annual rate increases. However, without these measures, the USPS will require government subsidies, substantial layoffs, reduced service, or facility closures to survive. In FY2024, the USPS is expected to incur a net loss of $6 billion or more.
5. **The USPS is central to the broader U.S. mailing system and provides essential services.** USPS's financial stability and service performance impact the entire industry and the millions of households and businesses that rely on the USPS for mail and package services. Failure to address the USPS financial crisis threatens the stability of the U.S. mailing industry, which supports 7.9 million American jobs and generates $1.9 trillion in revenue annually.

Figure E1.
Key Findings

Panel A. *Delivering for America* is Not Achieving its Goals

USPS Net Income (Loss) Excluding Workers Compensation (Billions)



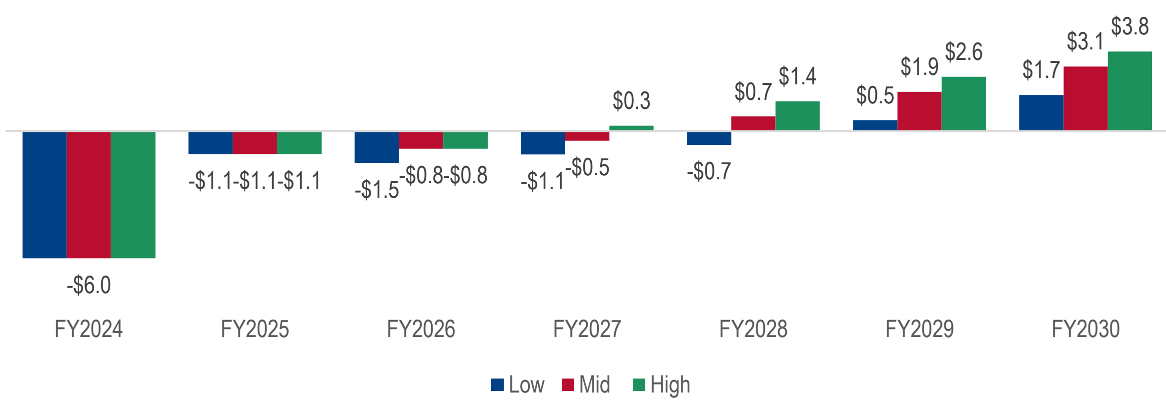
Panel B. A New Approach is Needed

Key Components of the Alternative Ratemaking Approach

Predictable, Moderate Rate Increases	Efficiency Requirement	Regulatory Reforms for Legacy Obligations
Annual increases tied to CPI for market dominant products	Requirement to improve cost management (or face reductions in rate authority). Simulation reduces annual real controllable costs by 2.5%	Elimination of CSRS and FERS amortization payments; ability to improve investment allocations

Panel C. USPS Can Achieve Financial Stability with An Alternative Ratemaking Model

USPS Net Income (Loss) Under Different Volume Scenarios Under an Alternative Ratemaking Approach (Billions)



*YTD is Q1 and Q2 FY2024; DFA Strategic Plan annual figure adjusted based on historical revenue share for the first half of the year (52% of total revenue). DFA projected the Plan would generate a net income of $1.7 billion in FY2024.

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June 28, 2024

BACKGROUND

The U.S. Postal Service (USPS) is an essential institution in the United States. The organization serves over 152.7 million residences and 12.7 million businesses.[2] It is solely responsible for collecting, processing, and delivering commercial, official, and household mail—often six days per week. The USPS is also fundamental to the broader U.S. mailing industry, which consists of 7.9 million American jobs, including 5.4 million associated with traditional mail and 2.5 million associated with package services.[3] These jobs generate $1.9 trillion in revenue annually. USPS's financial stability and service performance impact the entire industry as well as the millions of households and businesses that rely on it for mail and package services.

The reliability of the USPS has been a longstanding issue. The organization faces many challenges, including financial stability, service performance, a lack of accountability, and ineffective regulations. To address some of these issues, the USPS must revisit the goals and requirements outlined in the Postal Accountability and Enhancement Act of 2006 (PAEA), which is foundational to its operations today.

PAEA kept the restructuring of the USPS as an independent agency, established the current ratemaking system, and created a stronger regulatory body, the Postal Regulatory Commission (PRC), to increase transparency and oversight. The purpose of PAEA was to modernize the Postal Service. The legislation lays out guiding principles to improve the system, set service standards, and increase supervision of the Postal Service. (Table 1)

[1] Authored by Nam D. Pham, Ph.D., Managing Partner; Mary Donovan, Principal; and Stephanie Barello, Senior Consultant at ndp | analytics. The Association for Postal Commerce and the Greeting Card Association provided financial support to conduct this study. The opinions and views expressed in this report are solely those of the authors.
[2] USPS. "Postal Facts: Top Facts to Know About the U.S. Postal Service." (Accessed May 2024)
[3] Envelope Manufacturers Association Foundation Institute of Postal Studies. 2023. "EMA's 2023 U.S. Mailing Industry Economic Job and Revenue Study."

Table 1.
Guiding Principles Outlined in the Postal Act of 2006[4]

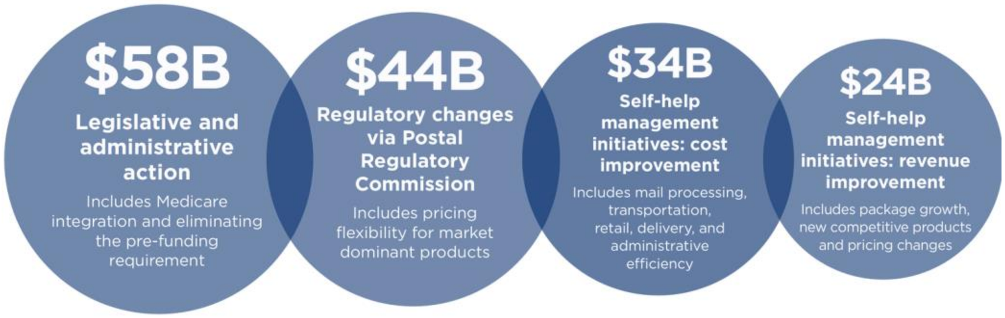
Modernization	Design a modern pricing and regulatory system that: • Provides flexibility to respond effectively to market and operational conditions, as well as the needs of all customers. • Provides incentives for the USPS and mailers to operate in a way that improves efficiency. • Supports the adoption of best practices, such as rational investments in the infrastructure and the realignment of resources to match the changing needs of customers and mailers to respond to system incentives. • Promotes honest, economical, and efficient management. • Allows USPS competitive products to compete fairly in the marketplace. • Maintains the price-cap basis of the 2006 reform legislation and avoids reverting to cost-of-service ratemaking principles. • Ensures adequate revenues to support the network and sets prices that cover costs as required by law. • Streamlines pricing and classification processes to increase predictability and reduce administrative burdens on all parties.
Service Standards	Have service standards consistent with universal service at reasonable prices that enhance the value of postal services and reasonably assure customers of delivery reliability and speed through transparent performance measurement systems.
Oversight	Work with the Postal Regulatory Commission and stakeholders to provide a high degree of financial transparency by improving the quality of postal data systems through warranted and cost-effective enhancements.

Since 2006, the USPS has struggled to achieve financial stability due to mismanagement, chronic inefficiency, poor oversight, obsolete legacy obligations, and a changing postal landscape. Indeed, since the implementation of PAEA, the USPS flagged severe concerns about its financial position as early as FY2010, noting: "Our ability to generate sufficient cash flows is substantially dependent on our ability to increase efficiency, reduce costs, and generate revenue, as well as on legislative change."[5] Early on, the USPS made some attempts to improve productivity. However, those efforts were quickly abandoned, allowing PAEA obligations to accrue on its balance sheet. More recently, the USPS has experienced accelerated volume losses to which it has been unable to respond with proportional reductions in resource use.

After 15 years of net losses, the USPS developed a new strategic plan to improve its trajectory called *Delivering for America* ("DFA" and "the Plan"). In March 2021, DFA was introduced to "[transform] the United States Postal Service from an organization in financial and operational crisis to one that is self-sustaining and high performing."[6] The Plan's success hinges on legislative and regulatory fixes, changes to ratemaking for market dominant products, cost management, and growth of its competitive products. (Figure 1)

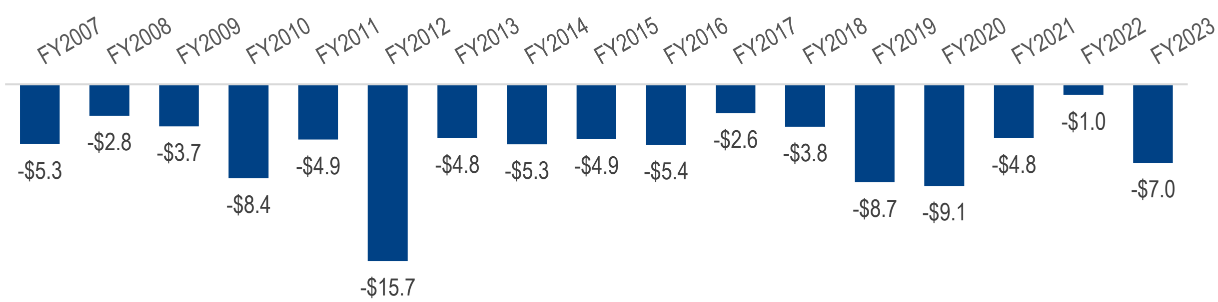
[4] USPS. "Postal Act of 2006." (Accessed Apr 2024)
[5] USPS. FY2010 Annual Report, 10K Filing, pp.5.
[6] USPS. 2021. "Delivering for America."

Figure 1.
Total DFA Plan Benefit[7]



Despite achieving legislative and regulatory wins and implementing aggressive, biannual rate increases that exceed CPI for market dominant products, the Plan has been ineffective at delivering results. Negative financial performance has continued, with the USPS assuming a $7.0 billion net loss in FY2023—the fifth worst year since PAEA was enacted in 2006. The comparatively modest loss of $1 billion in FY2022 benefited from an exceptionally favorable change in workers' compensation liability of about $2.1 billion; without this positive adjustment, USPS losses would presumably have been much larger.[8] (Figure 2)

Figure 2.
USPS Financial Performance After PAEA: Net Operational Loss (Billions)[9]

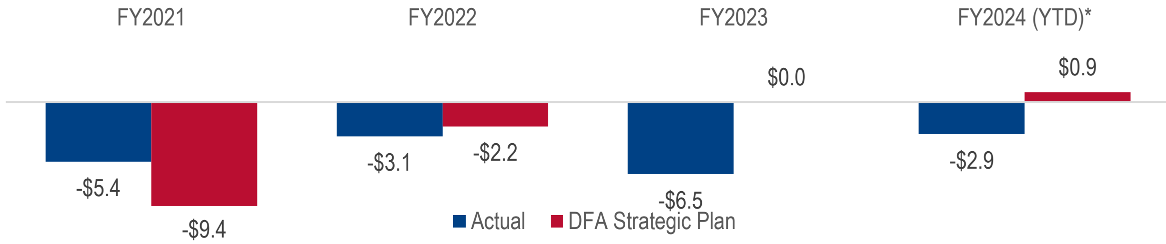


The difference between *Delivering for America's* net income projections and the USPS's actual performance does not follow a positive trajectory. Despite exceeding expectations in FY2021, driven partly by higher-than-expected volume, USPS's financial performance has since worsened. In fact, in FY2023, when DFA projected that the USPS would break even, the organization realized a net loss of $6.5 billion (excluding workers' compensation, which was not estimated in the Plan's forecast). The outlook for FY2024 appears to be similarly bleak. In the first half of the fiscal year, the USPS incurred a net loss of $2.9 billion, compared to an

[7] USPS. 2021. "Delivering for America." (pg. 6); Figured reproduced directly from source.
[8] USPS. FY2022 Annual Report, 10K Filing.
[9] USPS. 10K Filings; FY2022 is operation loss before the impact of USPS reform legislation.

expected income of $0.9 billion. By the year-end, total annual losses are expected to be $6 billion or more. (Figure 3)

Figure 3.
USPS Actual vs. Projected Net Income, Excluding Workers Compensation (Billions)[10]



*YTD is Q1 and Q2 2024; DFA Strategic Plan annual figure adjusted based on historical revenue share for the first half of the year (52% of total revenue). DFA projected the Plan would generate a net income of $1.7 billion in 2024.

The past 3.5 years have demonstrated that *Delivering for America* does not address the USPS's financial challenges. Moreover, the ratemaking approach that DFA implemented to generate revenue is taking a toll on the overall stability of the Postal Service because it coincides with steep volume losses. This has raised concern among the Postal Regulatory Commission. In its July 2024 rate approvals, the Commission states:

> "Although the price adjustments proposed in this proceeding are consistent with applicable law and the Commission has no legal basis to reject the proposed changes, **the Commission is concerned, given the current state of affairs, that the Postal Service's proposal does not reflect reasoned consideration of the potential widespread effects of its proposal, is not prudent, and is not consistent with the best interests of all stakeholders**."[11] [emphasis added]

A new approach is needed. The purpose of this study is to explore an alternative ratemaking model that would improve the Postal Service's financial position by controlling costs, retaining customers, and taking legislative and regulatory action to improve the ability of the USPS to reach financial stability.

AN ALTERNATIVE RATEMAKING APPROACH

PAEA was developed in response to a failing Postal Service and changing times. According to the White House, which called on Congress to act, there was significant concern that: "without significant modernization, the Postal Service will have three choices: dramatically roll back service, seek a rate increase of unprecedented scale, or fall even further into debt, potentially requiring a significant taxpayer bailout."[12] Approximately two decades later, the USPS is at the same crossroads, facing similar challenges. The past

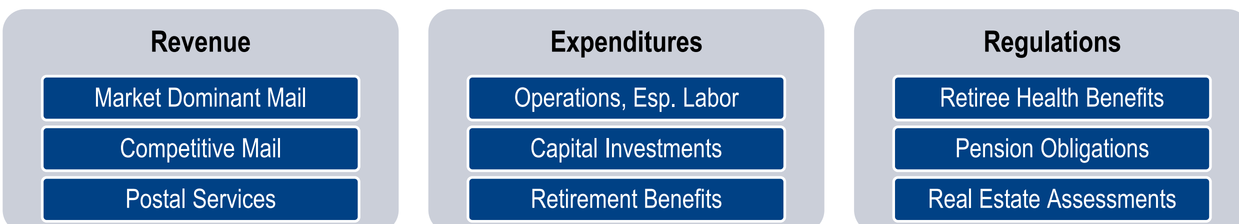
[10] USPS. 2021. "Delivering for America;" USPS. Preliminary Unaudited Financial Statements.
[11] PRC Order 7155 (May 2024)
[12] President's Commission on the United States Postal Service. 2003. "Embracing the Future: Making the Tough Choices to Preserve Universal Mail Service." Jul 31.

few years have demonstrated that rate increases of unprecedented scale and frequency will *not* resolve USPS woes. Continuing down this path will dramatically impact the Postal Service's ability to operate. Instead, an alternative approach is needed to achieve financial stability.

Factors Impacting USPS Financial Stability

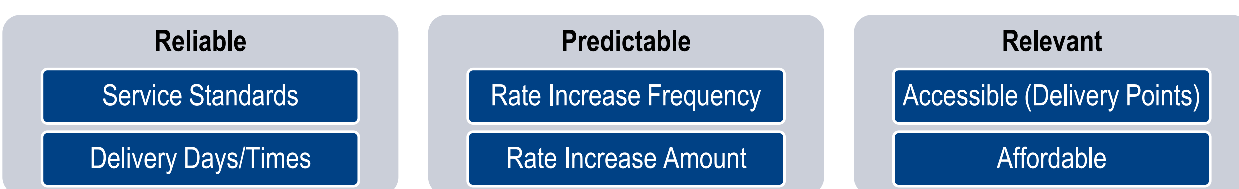
The USPS bottom line is a product of its revenue generation, expenditures, and legacy regulatory obligations, which impact spending, investments, and valuations. USPS revenue is generated primarily from market dominant mail, competitive mail, and postal services. USPS expenditures include operations (labor, transportation, supplies, and other costs), capital expenditures, and retirement benefits. The USPS is also impacted by legacy obligations, including regulations related to pension funds and asset valuations. Historically, the USPS was also severely burdened by its retiree health benefit pre-funding obligation. Since the obligation was removed under the Postal Service Reform Act (2022), the USPS's financial position has improved by $57 billion, which amounts to nearly the entire DFA benefit goal for legislative and administrative reform (see Figure 1).[13] (Figure 4)

Figure 4.
Factors Directly Impacting USPS Financial Stability



In addition to the factors directly impacting the USPS bottom line, indirect factors also influence it. The USPS must be dependable, predictable, and relevant to maximize the system's use and revenue. Reliability includes maintaining service standards, predictability includes the amount and frequency of rate increases, and relevance includes accessibility (delivery points) and affordability. (Figure 5)

Figure 5.
Factors Indirectly Impacting USPS Financial Stability



[13] PRC. 2022. "Financial Analysis of United States Postal Service Financial Results and 10-K Statement, FY2021." May 18.

Overview of Alternative Approach

Under *Delivering for America*, the USPS has relied too heavily on rate increases to sustain long-term financial stability, compromising volume. At the same time, USPS expenses have increased while productivity has declined. Legacy obligations and constraints limit the ability of the USPS to sustain its retirement programs and more appropriately value its assets.

The alternative approach includes the following key pillars:

1. Return to predictable, moderate market dominant rate increases.
2. Cost containment based on an efficiency requirement tied to real controllable costs.
3. Legislative and regulatory actions to eliminate amortization payments, modernize pension asset allocations, and improve the accuracy of USPS assets by using fair market value of properties.

Factor #1: Return to Predictable, Moderate Market Dominant Rate Increases

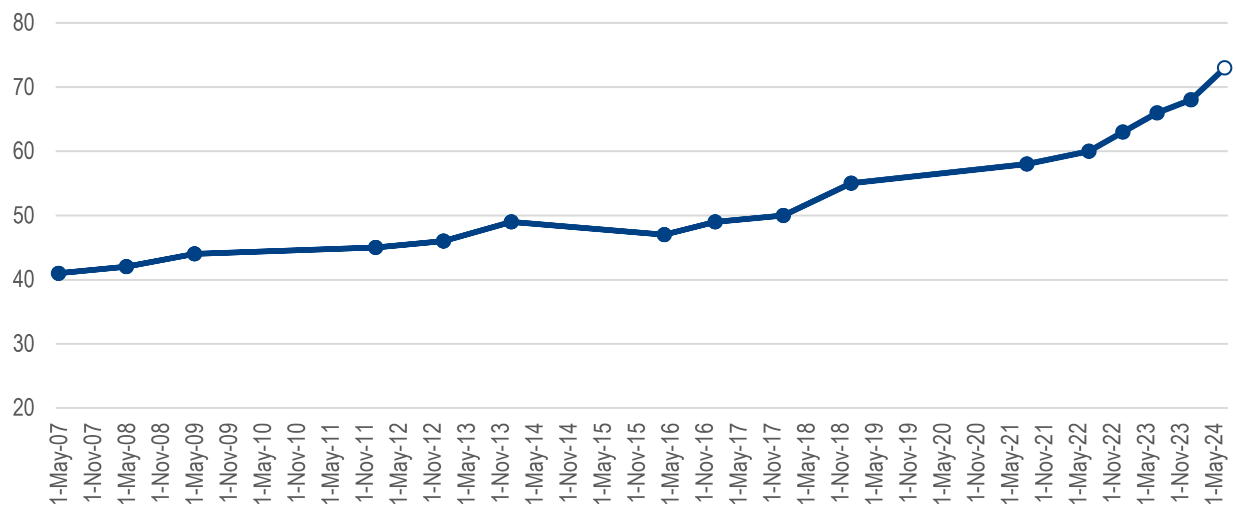
PAEA instructs the USPS to design a modern system that "streamlines pricing and classification processes to increase predictability and reduce administrative burdens on all parties."[14] This mandate resulted in annual rate increases capped at CPI, which was maintained until November 2020, when the PRC increased the rate authority of the USPS in response to the financial burden of its retiree health benefit pre-funding requirement (an obligation that has since been removed).[15] The USPS has capitalized on this increased authority as part of its *Delivering for America* objective to increase revenue generated from market dominant products.

While all USPS market dominant products are priced differently, the changes in First Class stamp prices illustrate the difference in ratemaking strategies for USPS customers before and after *Delivering for America*. Under the Plan, U.S. households and businesses experienced a more significant increase in stamp prices compared to the entire 15-year period after the passage of PAEA in 2006. From 2006 to 2020, First Class stamps rose 16 cents over the nine rate increases, an average of 1.78 cents per increase. In the four years after the implementation of *Delivering for America*, First Class Stamps will have risen by 18 cents over six rate increases (including the July 2024 increase), averaging 4.5 cents per increase. (Figure 6)

[14] USPS. "Postal Act of 2006." (Accessed Apr 2024)
[15] Extra rate authority was granted under PRC Order 5763 (Nov 2020).

Figure 6.
First Class Single Piece Letter Prices Since PAEA[16]

Panel A. Stamp Prices 2006-2024*



Panel B. Summary of Stamp Prices*

	Years	Number of Rate Increases	Beginning Price	End Price	Difference	% Difference
2006-2020	15	9	39 cents	55 cents	16 cents	41.0%
2021-2024*	4	6	55 cents	73 cents	18 cents	32.7%

*Includes July 2024 increase

Stamp prices are not an anomaly; most market dominant products are experiencing steep rate increases under *Delivering for America*. In July 2024, the average increase for Marketing and First Class Mail will be 7.8%. Rate increases for products within each category vary. For example, Marketing Mail Flats will increase by more than 11.7% and Carrier Route Mail by 9.9%. Periodicals, one of the most underwater categories for the USPS, will increase by nearly 9.8%. (Table 2)

[16] USPS. "Rates for Domestic Letters Since 1863" (Accessed May 2024); PRC Order 7155 (May 2024).

Table 2.
July 2024 Rate Increases for Selected Market Dominant Products[17]

Marketing Mail Products	
Overall	**7.76%**
Flats	11.71%
Carrier Route	9.92%
High Density/Sat Flats	7.90%

First Class Mail Products	
Overall	**7.76%**
Flats	9.68%
Single-Piece Letters/Cards	7.67%
Presort Letters/Cards	7.62%

Periodicals	
Overall	**9.75%**
Other Products & Services	
Media/Library Mail	9.87%
Ancillary Services	9.20%

USPS customers face higher rates and deteriorating service, which will drive volume even lower. Most recently, in Q2 FY2024, the USPS failed to meet its service targets in all categories except package services. The product segment with the worst performance was 3 to 5-day First Class Single Piece Mail, which missed its target by over 20 points; no states met the target. The USPS's inability to meet service targets is, in effect, a double failure. First, a target under 100% means that not all mail will be delivered to the service standard that customers pay for. For example, in Q2 FY2024, the USPS only expected to deliver about 90% of 3- to 5-day Single Piece Mail on time. Then, when the USPS misses its own targets, it fails to meet the lesser delivery standard. In Q2 FY2024, less than 70% of 2-day Single Piece Mail was delivered on time. (Table 3)

Table 3.
USPS Service Performance Scorecard, FY2024 Q2[18]

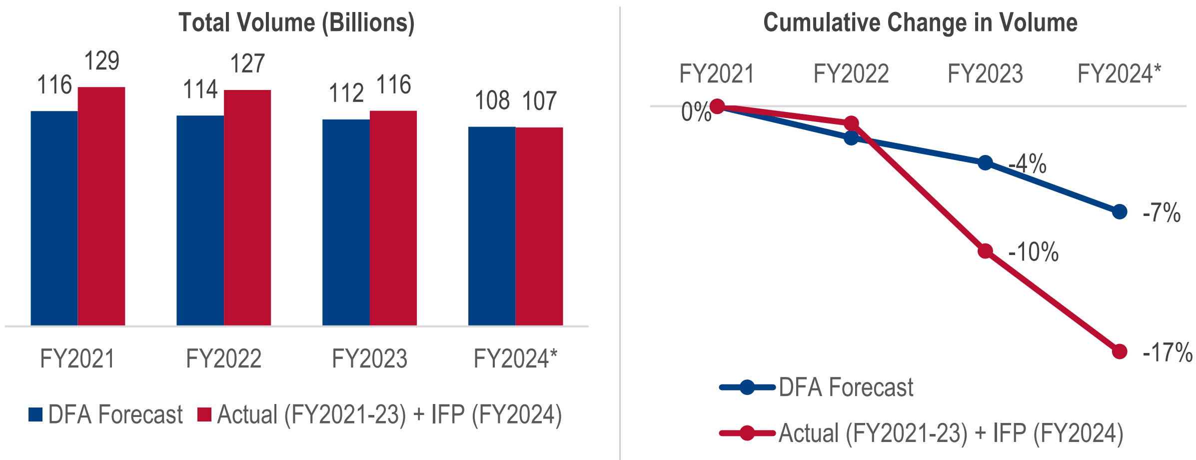
	Overall Service Performance		Performance by State	
	Target	Actual	States Above Target	States Below Target
First Class Single Piece				
2 day	93	86.8	4	46
3 to 5 day	90.28	69.9	0	50
First Class Presort				
2 day	95	91.3	11	37
3 to 5 day	93	83.8	0	50
Overnight	95	92.8	17	33
Marketing Mail				
End to End	94.62	90	4	46
Destination Entry	94.62	94.2	31	9
Package Services				
Standard service	90	94.3	49	1

More importantly, the USPS is realizing steep volume declines under DFA and its aggressive ratemaking strategy. DFA projected a 7% reduction in volume from FY2021 to FY2024. Actual volume declines are

[17] PRC Order 7155 (May 2024).
[18] OIG. "USPS Service Performance." (Accessed May 2024)

expected to be much worse. The USPS projects FY2024 volume to be 107.2 billion pieces, a 17% drop from FY2021 when volume was 128.9 billion. (Figure 7)

Figure 7.
USPS Mail Volume Declines Are More Severe than DFA Predicted[19]



*Projection

USPS's assertion that its market dominant products are not sensitive to price merits further examination. Our critique found that the USPS demand model, which produces elasticity of market dominant products and is used to forecast volume and revenue, is unreliable for predictive purposes.[20] For example, the results of demand equations for USPS products, such as Commercial High-Density and Saturation Letters and First Class Letters, are sensitive to small, reasonable changes to the model. These simple sensitivity analyses demonstrate that the model may not accurately estimate price sensitivity. As a result, the USPS and its Board of Governors cannot fully understand the impact of increasing rates on customer behavior and, ultimately, mail volume.

The Alternative Approach– Return to Moderate, Predictable Rate Increases to Stabilize Volume

Market dominant mail covers more than its share of USPS costs. Except for the onset and height of the COVID-19 pandemic in FY2020 and FY2021, USPS market dominant products have had higher cost coverage rates than competitive products. Most recently, in FY2023, the USPS market dominant cost coverage was 165.1%, while coverage for competitive products was 157.4%. (Figure 8)

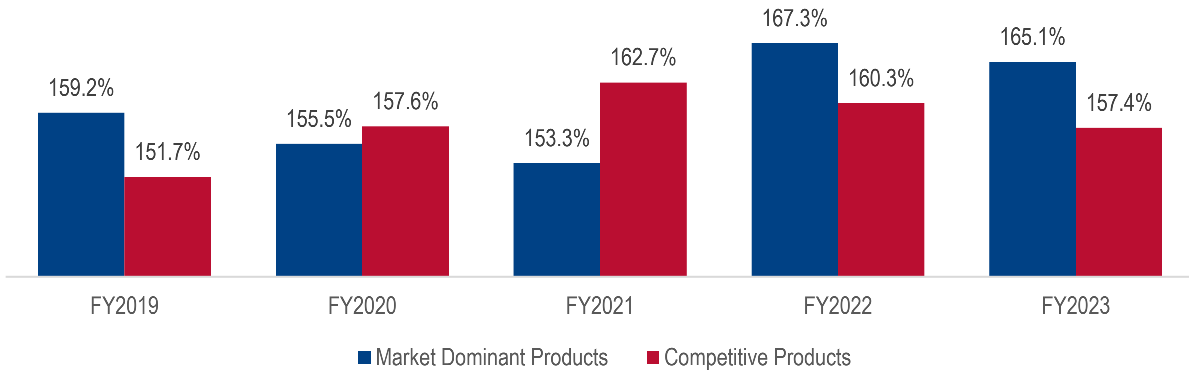
As a result, USPS market dominant products cover more institutional costs than competitive products. The DFA pricing strategy, which imposes unpredictable rate increases that exceed CPI twice per year, leans more on market dominant products to cover rising costs and capital investments—most of which are geared towards improving competitive product capabilities, including accepting, processing, and delivering parcels.

[19] USPS Quarterly Statistics Reports; USPS. FY2024 Integrated Financial Plan.
[20] Pham, Nam D., Ph.D., Mary Donovan, and Stephanie Barello. 2024. “Critique of USPS elasticities.” ndp | analytics.

Figure 8.

Market Dominant Products Have Higher Cost Coverage, Except During the Primary Pandemic Years[21]

USPS Cost Coverage, FY2019-23



The longevity of the USPS depends on sustained volume. Ratemaking strategies that lose volume faster than necessary compromise the USPS's financial position in the long run. Therefore, an alternative plan requires returning to predictable moderate increases, like the CPI cap implemented at the onset of PAEA.

Market Dominant Revenue

We created three scenarios to model volume and revenue under a return to moderate rate increases. Our previous research found that USPS elasticities are insufficient for modeling future volume changes. Instead, we assume that consumer sensitivity to changes in price is better reflected in historical mail patterns during different rate regimes. This approach assumes that external factors influencing future volume declines, like electronic diversion and generational trends, will be similar to the past—meaning their impact on volume declines over the next few years will continue at the same rate.

Under DFA, with biannual rate increases, annual market dominant mail volume declines averaged 6.4%. The two largest mail categories, First Class and Marketing Mail, averaged 5.1% and 7%, respectively. These rates are steeper than in the past. Before the COVID-19 pandemic, when USPS rate increases were capped at CPI, Market Dominant First Class Mail volume decreased by 3.2% per year, on average, and Marketing Mail only declined by 1.4%. (Table 4)

[21] USPS Public Cost and Revenue Analysis (CRA) Reports.

Table 4.
Market Dominant Volume Declines Are Worse Under DFA[22]
Annual Rates of Volume Decline (CAGR)

	First Class	Marketing Mail	All Market Dominant Mail
Severe Pace: DFA Trend Biannual Rate Increases (FY2021-24)	-5.1%	-7.0%	-6.4%
Average Pace: Long-Term Trend CPI & Biannual Rate Increases (FY2015-24)	-4.1%	-4.4%	-4.4%
Moderate Pace: Pre-pandemic Trend CPI Rate Increases, Pre-pandemic (FY2015-19)	-3.2%	-1.4%	-1.9%

*2024 data is IFP FY2024 Projections

We also assume that a return to moderate annual rate increases will not immediately impact consumer behavior. We expect current rates of decline to continue for some time before easing with the implementation of predictable annual CPI rate increases. We created three scenarios to model market dominant volume declines under the return to moderate, predictable rate increases. In the low scenario, the market dominant volume does not ease until FY2027, two years after the ratemaking change; then, it declines at an average pace for two years before returning to a moderate, pre-pandemic rate of decline. In the higher volume scenario, steep declines persist for one year, ease to an average pace for one year, and return to a moderate pace of decline in the third year. (Table 5)

Table 5.
Market Dominant Volume Declines Ease Under Alternative Ratemaking Approach

	Scenarios		
	Low Volume	Medium Volume	High Volume
FY2024	Projected based on Q1-Q2 FY2024 performance		
FY2025-FY2030	2 years at Severe Pace 2 years at Average Pace 2 years at Moderate Pace	1 year at Severe Pace 2 years at Average Pace 3 years at Moderate Pace	1 year at Severe Pace 1 year at Average Pace 4 years at Moderate Pace

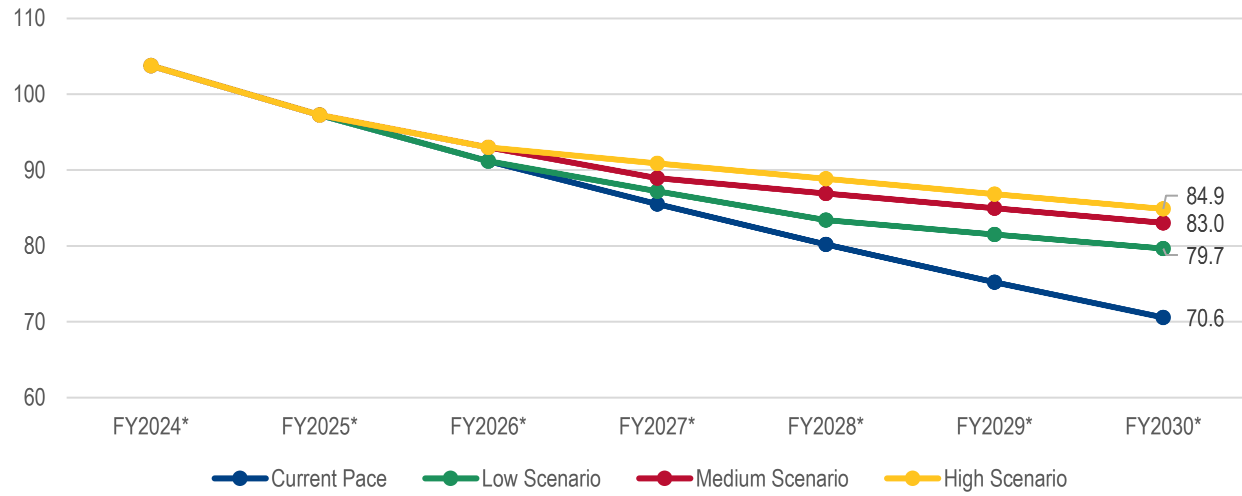
Note: Refer to Table 5 for rates of decline.

Under a more favorable ratemaking system, the USPS will be able to retain more volume. In the high scenario, where mailers return to pre-pandemic patterns more quickly, market dominant mail volume is expected to decline to 84.9 billion pieces, compared to 70.6 billion if DFA volume declines continue. Over

22 USPS Quarterly Statistics Reports; USPS. FY2024 Integrated Financial Plan.

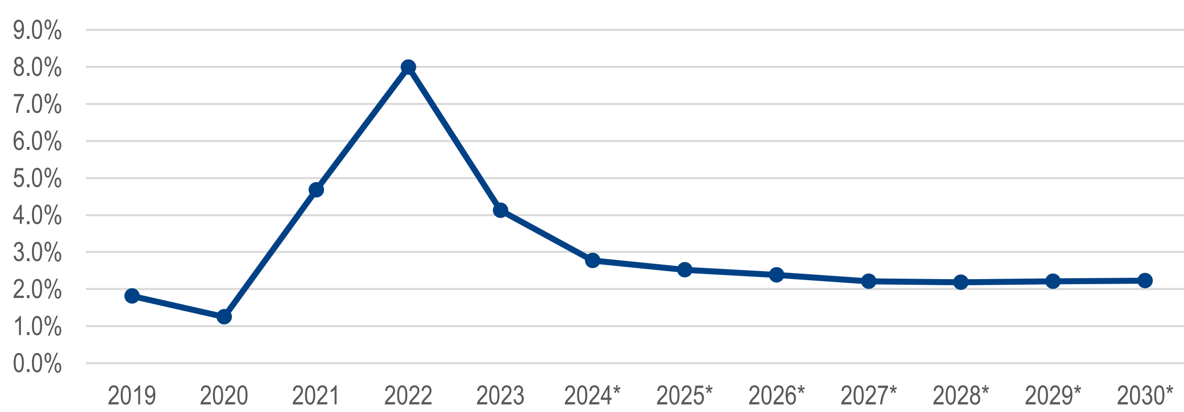
seven years, this scenario would retain 41.8 billion more pieces than the current pace (645.5 billion pieces in the high scenario versus 603.7 billion pieces in the current DFA trend). (Figure 9)

Figure 9.
Projected Market Dominant Volume Trends Under Different Scenarios (Billions)



Mail declines are expected to ease with the reintroduction of annual rate increases at CPI levels. According to the Congressional Budget Office, CPI is expected to return to normal levels, between 2% and 3%. (Figure 10)

Figure 10.
CPI is Forecasted to Ease to More Normal Levels[23]



*Projection

[23] Congressional Budget Office. Economic Projections (Feb 2024).

Under all scenarios, the USPS generates more revenue than planned in *Delivering for America*. From FY2024 to FY2030, the low scenario generates $306.3 billion, the medium scenario generates $311.7 billion, and the high scenario generates $314.6 billion. DFA forecasted $271.5 billion over that same period.[24] (Table 6)

Table 6.
Market Dominant Revenue* Projections for Alternative Ratemaking Scenarios (Billions)

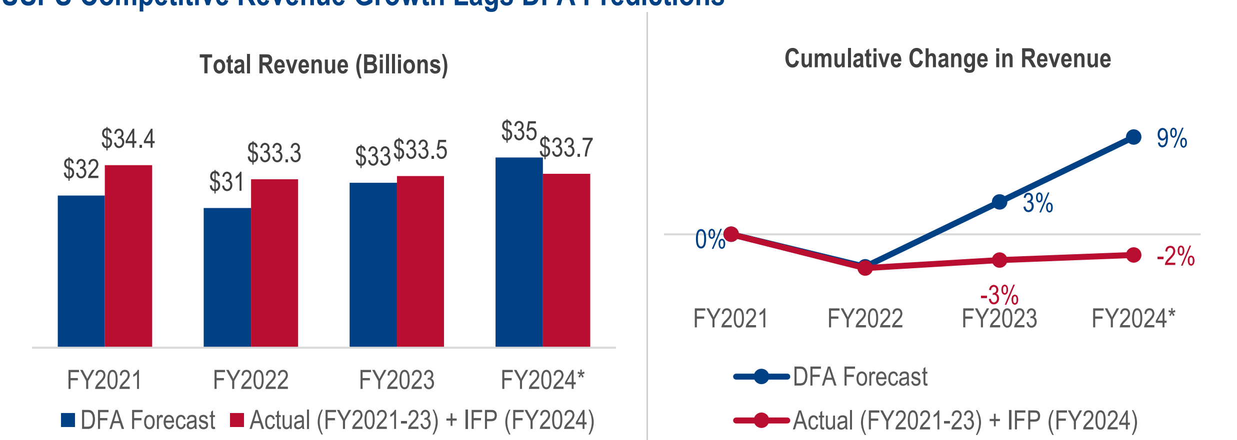
	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	7-Year Total
Low	$47.0	$45.5	$44.0	$43.2	$42.3	$42.2	$42.1	$306.3
Medium	$47.0	$45.5	$44.7	$43.8	$43.7	$43.5	$43.4	$311.7
High	$47.0	$45.5	$44.7	$44.6	$44.4	$44.3	$44.1	$314.6
DFA Plan	$40.8	$40.0	$39.2	$38.5	$38.1	$37.7	$37.2	$271.5

*Includes Market Dominant Services

Competitive Product Revenue

Competitive revenue growth, another pillar of *Delivering for America*, has not performed as expected. While actual performance surpassed the Plan's projections in FY2021 to FY2030, it is expected to fall short in FY2024, generating $33.7 billion in revenue compared to the projected $35.0 billion. The USPS projected that category to grow 9% during the first four years of the Plan, from FY2021 to FY2024. Instead, projected revenue for competitive products remains lower than FY2021. (Figure 11)

Figure 11.
USPS Competitive Revenue Growth Lags DFA Predictions[25]



*Projection

24 USPS. 2021. "Delivering for America."
25 USPS Quarterly Statistics Reports; USPS. FY2024 Integrated Financial Plan.

The timing of *Delivering for America* made it challenging to predict demand for USPS competitive products. Its package volume increased substantially during the pandemic; from FY2019 through FY2021, total growth was 41%. Then, in FY2022, volume dropped by over a billion. It has been slowly increasing since. Year-to-date, USPS's competitive revenue is 2.7% higher than in the same period in FY2023.[26] While DFA forecasted annual revenue growth of 4.5% for its competitive products, our analysis deflates growth expectations to 2.9%, slightly ahead of UPSP's performance year-to-date. (Table 7)

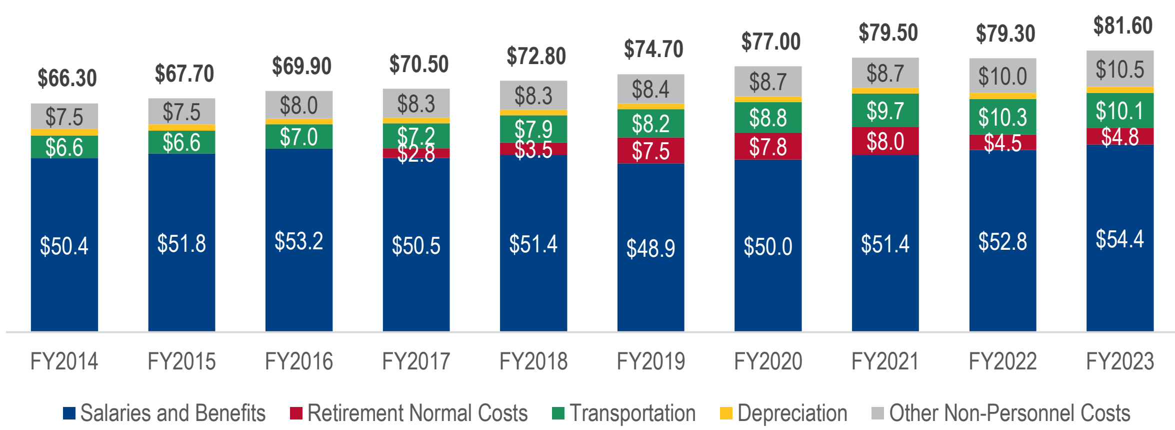
Table 7.
Competitive Revenue Projection for Alternative Ratemaking Scenarios (Billions)*

	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	7-Year Total
Scenario	$33.7	$34.7	$35.7	$36.7	$37.8	$38.9	$40.0	$257.4
DFA Plan	$35.0	$36.0	$38.0	$40.0	$42.0	$44.0	$45.0	$280.0

Factor #2: Controllable Cost Management

Despite higher-than-expected operating revenue, the USPS has failed to manage its spending. USPS controllable costs include salaries and benefits, transportation, supplies, equipment, rent, utilities, and other expenditures. Salaries and benefits are, by far, the most significant cost segment, reaching $54.4 billion in FY2023 and accounting for roughly two-thirds of controllable costs. (Figure 12)

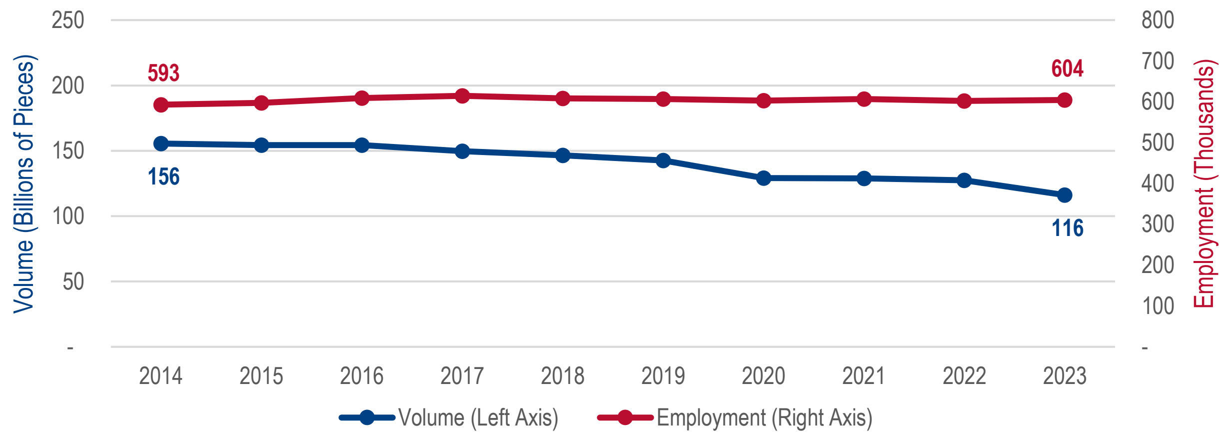
Figure 12.
Labor Accounted for Two-Thirds of Controllable Costs in FY2023
USPS Controllable Costs ($Billions), FY2014-23



[26] USPS. Preliminary Unaudited Financials, April 2024.

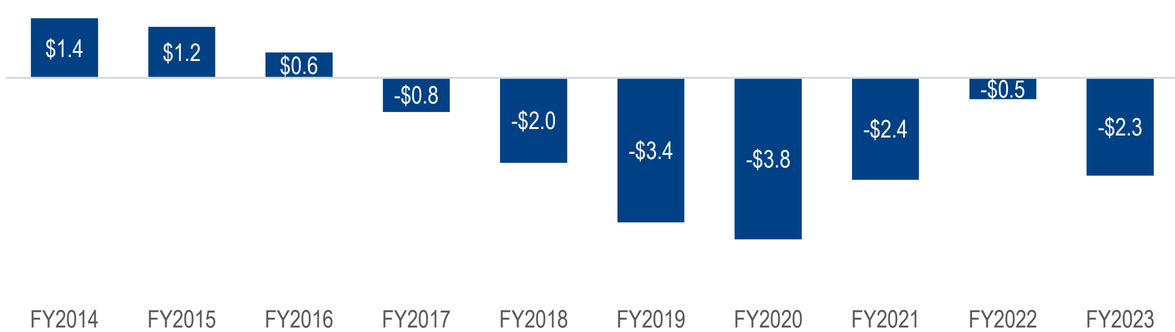
The size of the USPS labor force significantly impacts USPS spending on salaries and benefits. Even though mail volume has declined substantially, employment levels have remained flat over the past decade. USPS employment levels grew 2% from FY2014 to FY2023, while volume has declined by over 25%. (Figure 13)

Figure 13.
USPS Employment Remained Steady While Volume Declined[27]



Controllable costs have exceeded total revenues for years, putting the USPS in the red. Controllable income, which is total revenue less controllable expenses, has been negative since 2017. Though USPS retirement cost burdens have captured headlines, basic business operations have not been sustainable for a while. In FY2023, the USPS incurred a controllable loss of $2.3 billion. (Figure 14)

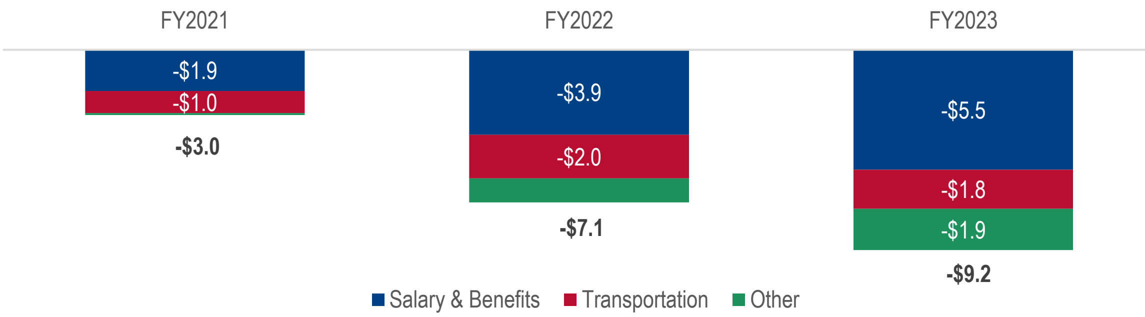
Figure 14.
USPS Continues to Post Annual Losses
USPS Controllable Income (Billions), FY2014-23



[27] Bureau of Labor Statistics. “All Employees, U.S. Postal Service [CES9091912001].” Retrieved via FRED, Federal Reserve Bank of St. Louis; USPS Quarterly Statistics Reports.

Delivering for America acknowledged the historical challenges of the USPS in improving efficiencies and optimizing its network. In response to these challenges, DFA outlined five targets for cost management related to delivery, transportation, mail processing, administration, and retail. These segments were expected to realize cost savings from $28 billion to $40 billion over ten years.[28] Yet, *Delivering for America* has not produced the savings it set out to achieve. In the Plan's first three years, the USPS spent $19.3 billion more than expected on controllable costs, including $3.0 billion in FY2021, $7.1 billion in FY2022, and $9.2 billion in FY2023. The difference between projected and actual spending on salaries and benefits accounts for over half of the annual overrun, reaching $5.5 billion in FY2023. (Figure 15)

Figure 15.
USPS Has Not Realized the Cost Savings Expected from DFA
Difference Between Actual and DFA Projected Controllable Costs (Billions)



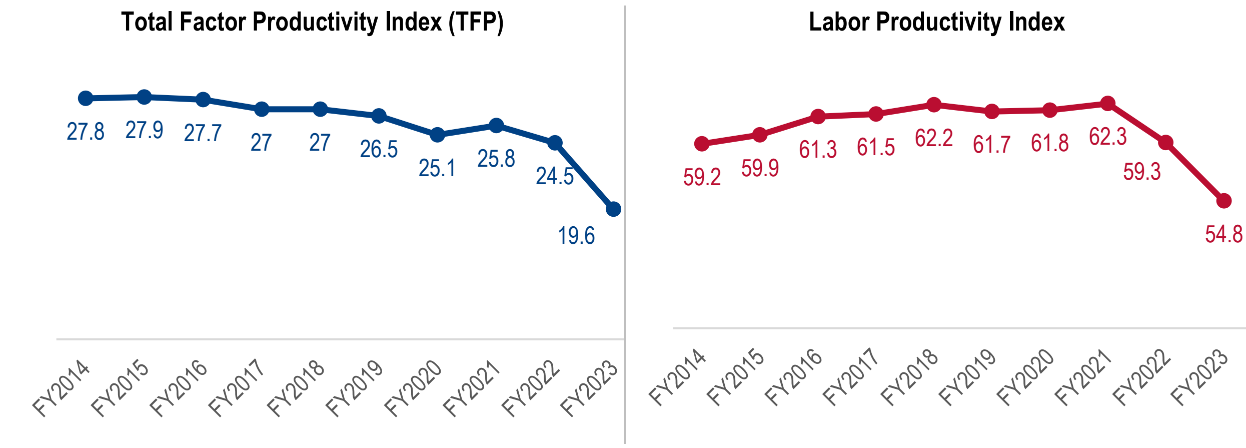
USPS Productivity

While inflation contributes to rising costs, it cannot be blamed for the organization's glaring productivity issues.[29] Over the past decade, USPS's total factor productivity (TFP) has decreased. TFP is a broad measure of productivity that includes all inputs, including labor, capital, and other materials. It has been a preferred measure of productivity for the USPS and is cited in its annual reports. Since the implementation of *Delivering for America*, TFP has dropped dramatically. Before DFA, from FY2014 to FY2020, TFP declined 2.7%, from 27.8 to 25.1 over 15 years. From FY2021 to FY2023, TFP declined by 6.2%, from 25.8 to 19.6, including a 4% decline from FY2022 to FY2023—the steepest single-year drop in productivity since this metric has been tracked. (Figure 16)

Since salaries and benefits constitute the most considerable portion of controllable costs, it is useful to examine labor productivity. Like TFP, labor productivity has also worsened under *Delivering for America*. However, unlike TFP, labor productivity improved before DFA was implemented. The measure increased from 59.2 in FY2014 to its decade-high of 62.3 in FY2021. Since then, labor productivity has eroded as volume declined and employment levels remained stable. During the first three years of DFA, USPS workforce productivity dropped 7.5 points, from 62.3 to 54.8. Similar to TFP, the USPS labor productivity trend is marking record lows. (Figure 16)

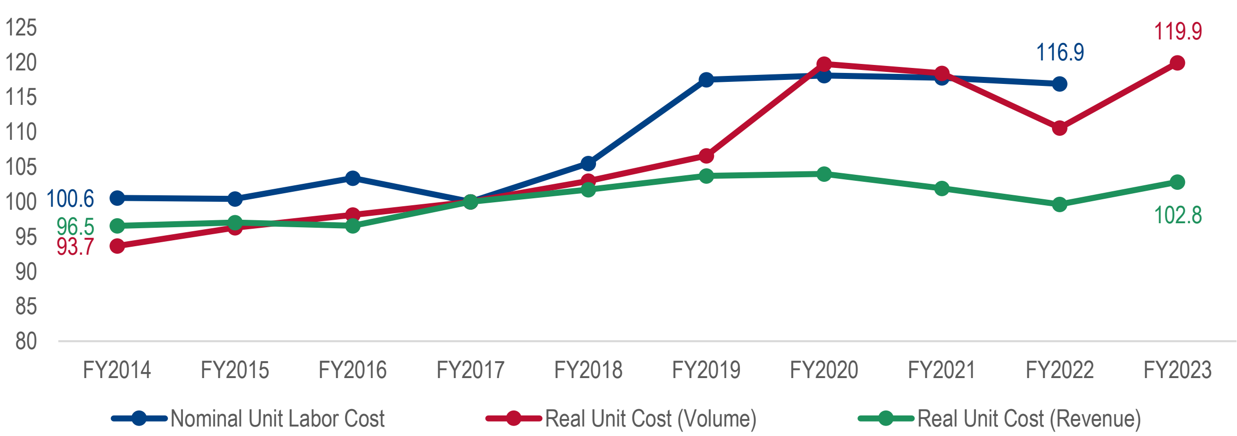
[28] USPS. 2021. "Delivering for America."
[29] Inflation also *helps* USPS by creating rate authority. Additionally, inflation does not impact all costs because not all employees get cost of living adjustments (COLAs), and USPS commodities purchases are not part of the CPI bundle.

Figure 16.
Productivity Has Declined Under *Delivering for America*[30]



Another way to examine USPS productivity is by unit cost, which is the ratio of costs to output. In other words, it shows how much it costs a business to produce one unit of output. BLS nominal unit labor costs data for USPS grew from 100.6 in 2014 to 116.9 in 2022. USPS real (inflation-adjusted) unit costs based on revenue increased from 95.6 to 102.8 between FY2014 and FY2023. During this time, real unit costs by volume rose from 93.7 to 119.9. (Figure 17)

Figure 17.
USPS Unit Labor Costs Have Increased[31]
Index (2017=100)



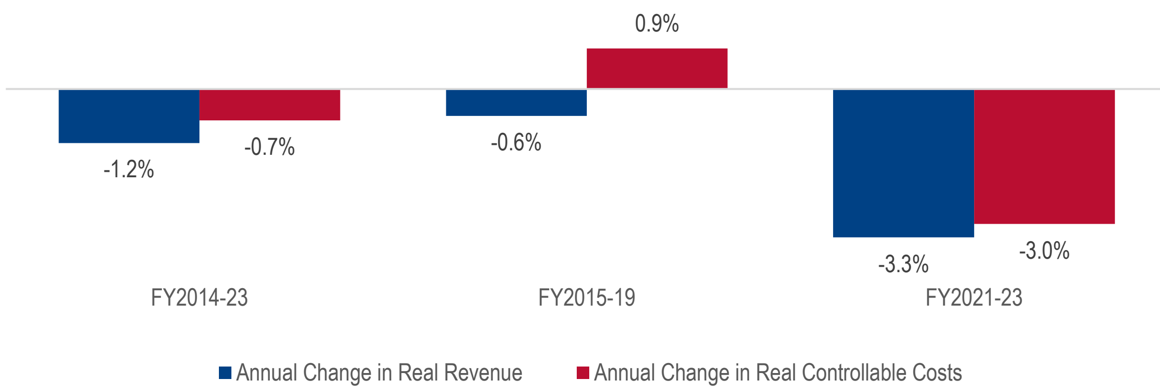
30 USPS. FY2023 Annual Report to Congress.
31 Bureau of Labor Statistics; Author calculations based on USPS expenditures, revenue, volume, and inflation.

The Alternative Approach – Add an Efficiency Requirement in USPS Ratemaking to Control Costs

No matter how the data is sliced, productivity is declining, and USPS customers are bearing the cost of its inability to reduce spending in line with volume declines. More must be done to manage USPS expenditures. Doing so will boost flagging productivity and create a more sustainable future.

After adjusting for inflation, USPS revenue is declining faster than costs. Over the past decade, the average annual decline in real revenue was 1.2%, while real controllable expenses slowed by 0.7%. In the five years before the COVID-19 pandemic, real costs rose while revenue declined. In the first three years *of Delivering for America*, FY2021 to FY2023, the annual pace of real revenue decline was 3.3%, while controllable costs decreased by 3.0%. (Figure 18)

Figure 18.
Declines Real Revenue Are Steeper Than Controllable Costs
Average Annual Change in Real Controllable Costs and Revenue (CAGR)



To reach financial stability, USPS's cost improvements must be greater than declines in real revenue because its controllable costs exceed revenue, even with biannual rate increases. The concept of an efficiency requirement is to institute a cost reduction requirement to justify consumer rate increases (an "X-Factor" is an example of such a requirement).[32] The USPS must improve its productivity before passing costs to customers and facilitating further volume attrition from the system. Our efficiency requirement is tied to real controllable costs.[33] From FY2014 to FY2023, USPS real revenue declined by 1.2% per year (CAGR). Since the implementation of *Delivering for America*, which coincided with high inflation, real revenue declined 3.3% on average. We used this general range to assess the impact of efficiency requirements, from 1.0% to 3.5%, on USPS controllable costs from FY2024 to FY2030. (Table 8)

[32] The concept of performance-based rate authority, such as an "X-Factor," is not new. It was discussed by OIG as early as 2001 and has been brought forth by industry and others as an incentive for USPS to improve operational efficiency.
[33] Note: In *Delivering or America*, cost savings mirrored to real (inflation-adjusted) changes in revenue.

Table 8.
Impact of Different Efficiency Requirements on Nominal Controllable Costs

Efficiency Requirement (Annual Decline in Real Costs)	1.0%	1.5%	2.0%	2.5%	3.0%	3.5%
Equivalent Annual Change in Nominal Costs, FY2024-2030	1.2% to 1.5%	0.7% to 1.0%	0.1% to 0.5%	0.0% to -0.4%	-0.9% to -0.6%	-1.1% to -1.4%

Efficiency requirements could vastly shift the direction of the USPS. A 3.5% annual reduction in real controllable costs would reduce nominal expenses from $82.5 billion in FY2024 to $76.6 billion in FY2030. Over that period, the USPS would save $44.3 billion more than a 1.0% efficiency requirement. For modeling purposes, 2.5% was selected for our alternative ratemaking approach, a reduction in nominal controllable costs up to 0.4% annually.[34] For context, the USPS anticipated a 1.1% increase in nominal costs from FY2023 to FY2024.[35] More aggressive cost management is needed. Measured reductions in labor, such as attrition opportunities, would help the USPS meet a more aggressive cost control target. (Table 9)

Table 9.
USPS Controllable Costs Under Different Cost Containment Strategies (Billions)

Efficiency Requirement	FY2024	FY2025	FY2026	FY2027	FY2028	FY2029	FY2030	7-Year Total
1.0%	$82.5	$83.7	$84.9	$85.9	$86.9	$87.9	$89.0	$600.8
1.5%	$82.5	$83.3	$84.0	$84.6	$85.1	$85.7	$86.3	$591.7
2.0%	$82.5	$82.9	$83.2	$83.3	$83.4	$83.6	$83.7	$582.6
2.5%	$82.5	$82.5	$82.3	$82.0	$81.7	$81.5	$81.2	$573.8
3.0%	$82.5	$82.1	$81.5	$80.8	$80.1	$79.4	$78.7	$565.1
3.5%	$82.5	$81.6	$80.7	$79.5	$78.4	$77.4	$76.3	$556.5

Cost savings can be achieved with productivity improvements. This may require workforce reductions or a transition from career to non-career workers. Given expected declines in real revenue, the USPS workforce may need to "right size" by 10% to 12%.[36] Alternatively, DFA outlined $34 billion in savings from transportation, mail processing, delivery, and other efficiencies, which could contribute to this requirement.[37] Savings may also be found through legislative action. For example, other federal agencies receive Congressional appropriations for pension programs, while the USPS must fund its with revenue. In FY2024, the normal cost of the USPS FERS contribution was estimated at $5.0 billion (6% of controllable costs).

[34] Our simulations expect real revenue to decline by 1.4% to 1.9% annually. The efficiency factor must be greater to reduce the gap and balance out costs and revenue.
[35] USPS. FY2024 Integrated Financial Plan.
[36] Based on historical averages of real revenue per worker.
[37] USPS. 2021. "Delivering for America."

Factor #3: Policy Reforms to Address Retirement Costs and Other Limitations

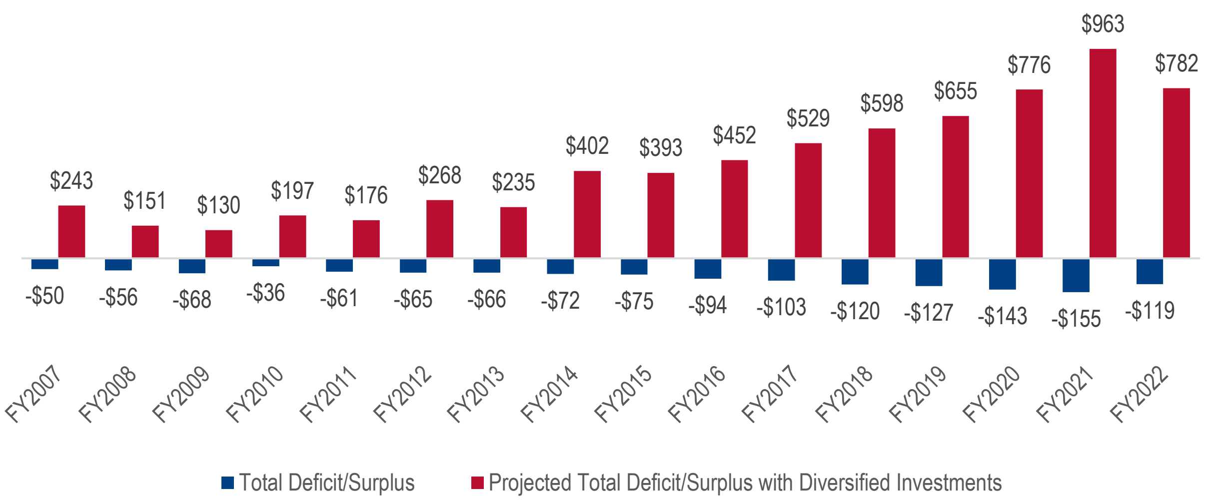
The USPS is burdened by obsolete legacy obligations that impact ratemaking and, ultimately, ratepayers. The USPS bears unnecessary costs related to retirement programs because investment limitations produce low returns. Additionally, USPS assets are undervalued, resulting in a balance sheet underestimating its financial position. Because assets appear lower than liabilities, it supports USPS's justifications for rate increases. Applying a fair market value to USPS properties would result in a net positive on its balance sheet.

Retirement Obligations

The USPS contributes to three retirement programs: the Civil Service Retirement System (CSRS), the Federal Employee Retirement System (FERS), and the Postal Service Retiree Health Benefits Fund (PSRHBF). Funding requirements and investment limitations related to these programs uniquely burden the USPS.

Rules governing the asset allocation of pension funds restrict USPS's ability to sustain its retirement programs. By law, USPS funds can only be invested in Treasury securities, which generate lower returns than standard investments.[38] If the USPS were permitted to implement a more aggressive investment strategy for these funds, its pension program would have a vastly different outlook. The OIG estimates that if USPS funds were invested with a 60% stock and 40% bond allocation from inception, the total fund balance would have been $782 billion in FY2022. Instead, the USPS has had an aggregate deficit in the three funds since 2007. (Figure 19)

Figure 19.
Diversified Investments Could Have Generated Large Surpluses[39]
Actual and Hypothetical USPS Fund Balances (Billions)



[38] OIG. 2024. “Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges.” Jan 8., pg. 7.
[39] OIG. 2024. “Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges.” Jan 8., pg. 8.

In addition to having no ownership over investment strategies, the USPS must fund its programs entirely from revenue and cover amortization payments. No other federal agency shares this obligation. Other agencies receive Congressional appropriations to cover employer contributions to CSRS and FERS, while the U.S. Treasury covers amortization payments.[40] These requirements negatively impact the USPS's financial position and are ultimately passed on to customers who pay higher rates to generate more revenue for the USPS to cover these costs.

The USPS CSRS program bears additional costs due to unequal treatment of Postal Office Department (POD) employee retirement benefits. According to the OIG, the way in which the CSRS pension costs for the Post Office Department service were allocated between the Postal Service and the federal government was unfair. Splitting past costs by years of service would increase the CSRS fund by $75 billion. In the OIG 2018 update, these savings grew to $111 billion using an alternative methodology.[41]

CSRS re-evaluation was included in *Delivering for America bu*t has not yet been implemented. The DFA CSRS reform would allow the USPS to change the allocation method and eliminate amortization payments. The USPS estimates this will save $14 billion over ten years. While FERS reform was not incorporated into the DFA plan, correcting the program's investment strategy or adjusting the system so that the USPS receives support like other federal agencies would vastly improve its ability to support its retirement programs and improve financial stability.

Valuation of Real Estate Assets

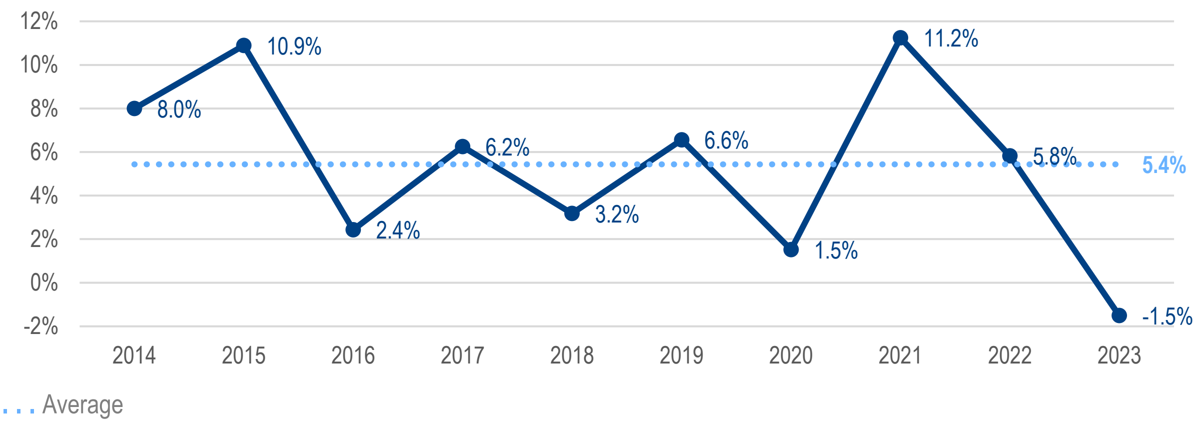
The Postal Regulatory Commission relies on the USPS income statement and balance sheet to justify using its retirement and density authority for rate increases that exceed CPI. On its balance sheet, the USPS appears to have higher liabilities than assets, which supports its justification for higher rate increases. In FY2023, total USPS assets were $45.3 billion, while total liabilities were $68.4 billion.[42] However, these figures are misleading. The valuation of USPS' properties is hugely understated; therefore, its assets are underestimated on its balance sheet.

The USPS values its real estate assets at net book value instead of market value.[43] This approach vastly undervalues USPS's properties. In 2014, the OIG reported that the net book value of USPS properties totaled $13.2 billion, while the fair market value was as high as $85 billion (equal to $116.1 billion in 2024).[44] In 2020, the USPS owned 8,400 facilities that amounted to 200 million square feet of interior space and 900 million square feet of land.[45] In its most recent annual report, the USPS stated that it owns nearly 8,500 facilities, totaling $30.3 billion in property assets at cost, including $27.5 billion for buildings and $2.9 billion for land. After depreciation and amortization, the net value of all USPS property and equipment, including vehicles, equipment, and leasehold improvements, was only $16.3 billion.[46]

[40] OIG. 2024. "Postal Retirement Funds in Perspective: Historical Evolution and Ongoing Challenges." Jan 8.
[41] OIG. 2023. "USPS OIG Work on Retiree Liability Issues." Jun 22.
[42] USPS. 10K Annual Report, FY 2023.
[43] OIG. 2015. "Considerations in Structuring Estimated Liabilities (FT-WP-15-003)." Jan 23.
[44] BLS. CPI Inflation Calculator (Jun 2012 to Apr 2024).
[45] Zaiac, Nick. 2020. "The Postal Service's untapped real estate fortune." R Street Institute. Apr 23.
[46] USPS. 10K Annual Report, FY 2023.

The market value of properties is significantly higher than what is reported at cost. Commercial real estate prices have increased by 5.4% per year, on average, in the past decade, rising 54.4% from 2014 to 2023. Accurately reflecting the market value of USPS properties on its balance sheet would vastly alter the difference between its assets and liabilities. To make this change, regulatory reform is required to allow USPS to calculate the value of its assets at fair market rates.[47] (Figure 20)

Figure 20.
Commercial Real Estate Prices Have Increased 5.4% Each Year, On Average[48]



An Alternative Approach – Institute Regulatory Reforms for Long-Run Financial Improvements

While recent legislation resolved the $57 billion in retirement health benefits pre-funding obligation, which significantly improved USPS's overall financial position, the USPS is currently unable to lower retirement-related costs or generate higher fund balances for its pension funds, which would have eliminated the current burden on amortization payments.

USPS customers should not bear the costs of outdated legacy obligations. The Postal Service should be able to optimize its asset allocations in line with state pension funds and other similar retirement programs that balance risk and return. This would improve USPS retirement fund balances and the USPS financial position overall. Additionally, to correct historical limitations imposed on USPS related to retirement obligations, the FERS and CSRS amortization payments should be eliminated or receive congressional coverage of these payments like other government agencies.

[47] Effectuating the revaluation of USPS hard assets to fair market value would need to account for the fact that assets taken over from the Post Office Department (POD) in 1971 were required to be valued at depreciated original cost. Valuing assets taken over from the POD at depreciated original cost is a statutory requirement (39 USC 2001(a)(1), now section 2002(a)(1)). It would be necessary to sort assets into those taken over from the Cabinet Dept. in 1971 and those acquired by USPS.
[48] International Monetary Fund. Commercial Real Estate Prices for United States." Retrieved via FRED, Federal Reserve Bank of St. Louis, May 2024.

Table 10.
Alternative Ratemaking Approach Requires Legislative and Regulatory Reforms to Reduce Barriers

CSRS	Amortization payments eliminated by legislation
FERS	Amortization payments eliminated and funds diversified by legislation
Real Estate Valuations	Change asset calculations from net book value to fair market value

Total Impact of Alternative Ratemaking Approach

Delivering for America has not put the USPS on a sustainable path forward. The first third of the 10-year plan has been plagued with steep market dominant volume declines, poor service performance, and rising costs.

The alternative ratemaking plan includes three pillars: 1) return to moderate annual rate increases, 2) introducing an efficiency requirement to control costs, and 3) regulatory reforms to alleviate obsolete legacy obligations related to retirement programs and improvements to balance sheet calculations that more accurately reflect USPS assets.[49] Additionally, the USPS must find ways to improve its service performance. Considerations may be made to include minimum performance standards in ratemaking. Currently, customers are paying more for worse service, a combination that negatively impacts volume.

To model the impact of the alternative ratemaking approach, we constructed three scenarios with varying rates of decline in market dominant volume. Since USPS elasticities are unreliable and the *Delivering for America* ratemaking system is unprecedented, volume changes after returning to a moderate CPI approach are challenging to forecast. Therefore, a set of scenarios provides a better sense of the potential range of impact. The momentum of decline is not expected to change overnight, even with the return to moderate annual rate increases that track inflation. The annual rates of volume decline, calculated by category and based on historical trends (see Table 6), aggregate to 4.3% in the low scenario, 3.6% in the medium scenario, and 3.3% in the high scenario. Our aggregate revenue projection includes modest increases in competitive product revenue and a continued decline for international products. (Table 11)

[49] USPS financials categorize amortization payments as “non-controllable costs” because these expenditures cannot be changed in the short run. However, the USPS does have control over workforce decisions which impact these costs over time. Therefore, we call these expenditures “long-run variable costs.” The USPS can control over its future obligations with smart decisions about its workforce today.

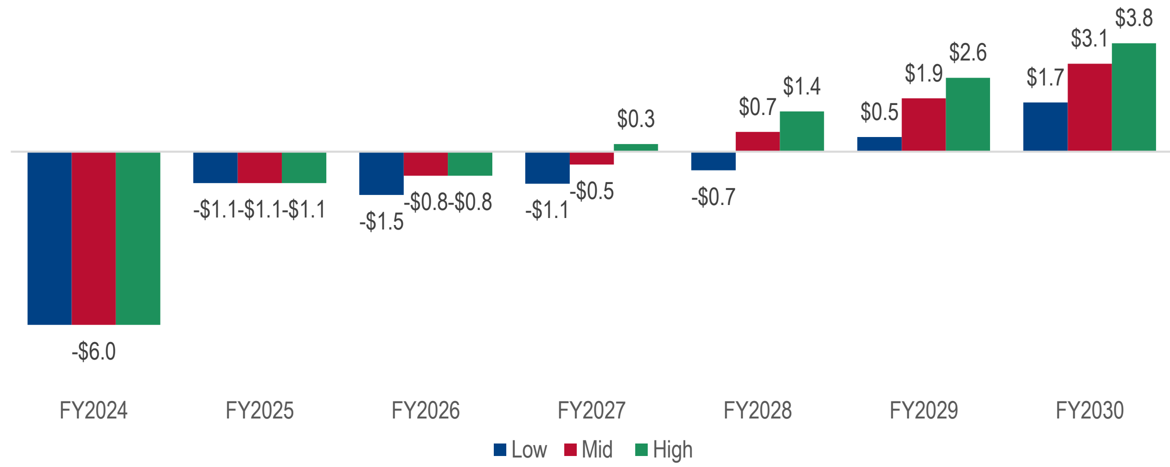
Table 11.
Assumptions to alternative rate approach scenarios

	Low	Medium	High
Market dominant rates	Annual CPI Increases starting in FY2025		
Market dominant volume	-4.3% CAGR	-3.6% CAGR	-3.3% CAGR
Competitive revenue	2.9% annual increase		
International mail revenue	5% annual decline		
Controllable expenses	Efficiency requirement: -2.5% change in real costs annually		
Long-run variable ("non-controllable") expenses			
RHB amortization	Eliminated by PSRA		
FERS amortization	Eliminated by legislation and diversification of funds in FY2025		
CSRS amortization	Eliminated by legislation in FY2025		
Other Actions	Change in Real Estate Asset Calculation Method to Fair Market Price		

Under all three scenarios, the USPS can reach a breakeven point before FY2030. As volume declines ease and the efficiency requirement takes effect, the USPS will reach positive net income. However, regulatory reform and legislative action are required. The inability of the USPS to invest in a meaningful asset allocation for its retirement programs, paired with revenue-funded employer contributions and amortization payments, is hampering its ability to serve its U.S. households and businesses.

In FY2024, the USPS is expected to realize a net loss of $6.0 billion or more, driven mainly by FERS and CSRS amortization payments and a $0.5 billion net loss from controllable costs overrunning revenue. Due to a lag in customer behavior, USPS volume declines are expected to continue to be severe in FY2025, even with immediate return to annual CPI rate increases. However, in time, USPS market dominant mail volume declines are expected to ease as the rate increases moderate. The breakeven year is FY2027 under the high volume scenario and FY2029 under the low scenario. By FY2030, the high scenario produces a net income of $3.8 billion. The medium and low scenarios generate $3.1 billion and $1.7 billion, respectively. (Figure 21)

Figure 21.
USPS Net Income Under Different Alternative Ratemaking Approach Scenarios ($Billions)



CLOSING

Delivering for America and its unprecedented ratemaking approach have not improved USPS's financial position. Mail volume has experienced steep declines, controllable costs continue to rise, and outdated legacy obligations impact the ability of the USPS to sustain its retirement programs and accurately value its assets. These issues directly impact U.S. households and businesses, which have been subject to aggressive, biannual rate increases that exceed CPI in an attempt to provide financial cover for these challenges.

Continued USPS instability threatens the broader mailing industry and hurts U.S. households and businesses that rely on the organization to send and receive mail. As a result, a different approach to ratemaking is called for. Our research finds that the USPS can return to annual CPI rate increases by implementing an efficiency factor that requires the USPS to reach annual cost management targets as part of its justification for rate increases. The approach also requires Congress and the PRC to address the burden of the USPS retirement program because the USPS has no control over managing the funds—even though it is the only federal agency required to pay contributions and amortizations from its revenue. Finally, the USPS financials should be updated to reflect fair market valuations of its properties; this change would result in a net positive balance sheet for the Postal Service.

After leaning on ratepayers for the past three years without the intended financial results, it is time for the USPS to look inward at its productivity and cost management. By doing so, the USPS can identify avenues to improve its financial position while maintaining as much volume as possible in the system—ensuring that the Postal Service can serve future generations of Americans.

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