The USPS Strategic Plan, *Delivering for America*: An Evaluation of Key Metrics and Vulnerabilities

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Nam Pham, Ph.D. and Mary Donovan[1]

Delivering for America ("DFA") is the United States Postal Service (USPS)'s 10-year strategic plan implemented in FY2021. The DFA was created amid significant uncertainty with the COVID-19 pandemic, making it challenging to project market dominant and competitive product performance and estimate future costs to the USPS. Now that the DFA is in its third year of implementation, ndp | analytics examined USPS performance compared to DFA projections and current economic trends. The findings show that the assumptions and projections made in the DFA are no longer valid, and the DFA is not achieving its intended goals.

Key takeaways:

1. **The USPS's base year estimates in the DFA are inaccurate.** The USPS underestimated total mail volume by nearly 13 billion pieces for the base year of the plan, throwing off the entire USPS projection for both volume and revenue.

2. **Market dominant mail fueled USPS revenue gains in FY2021-22 without excessive rate increases, contributing to better financial performance than projected under the DFA.** In FY2021-22, higher-than-projected volume contributed to higher revenue for market dominant products ($8.1 billion over two years). This revenue improvement led to better financial outcomes for the USPS during this period.

3. **After back-to-back rate increases under the DFA, USPS mail volume is starting to decline at a faster rate in FY2023, compromising revenue and overall financial stability.** Year-to-date, market dominant mail volume and revenue have started to decrease at a faster rate than prior years and are underperforming expectations.

4. **Competitive products are not growing as expected under the DFA.** Year-to-date, USPS competitive product volume and revenue growth rates are below the levels predicted in the DFA. Despite its underperformance, the USPS is reducing rates for competitive products while raising rates for market dominant mail and investing $40 billion in capital improvements which largely focus on package growth.

[1] Nam D. Pham, Ph.D. is Managing Partner and Mary Donovan is Principal at ndp | analytics. Stephanie Barello provided research assistance. 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.

5. **Efficiencies expected under the DFA have not been realized.** USPS costs have overrun the plan's projection. Recent data suggests that the DFA's efforts to cut costs have not materialized. While inflation has increased costs, USPS labor productivity has declined, indicating that the USPS has not improved its operational efficiency.

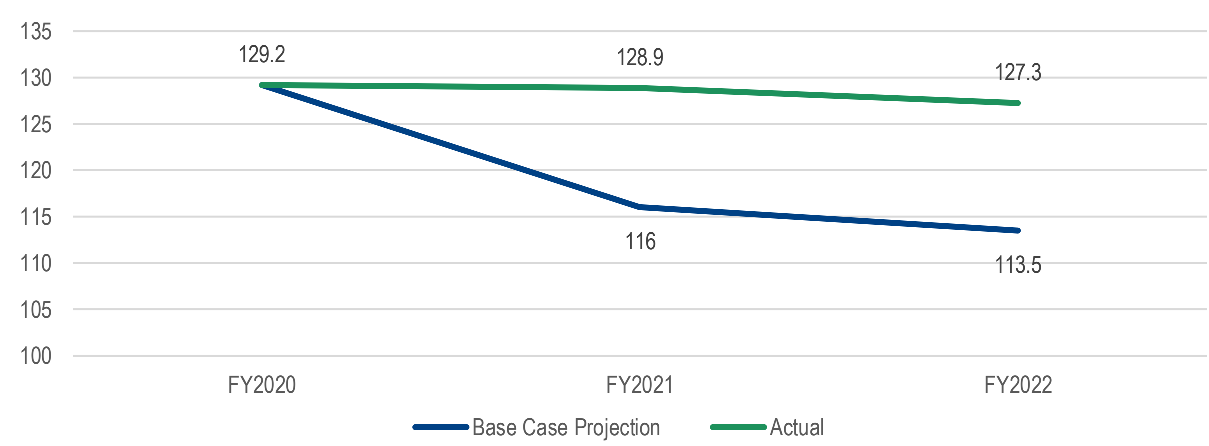
6. **Economic conditions have changed since the development of the DFA.** The economic assumptions, especially for inflation, used to create the DFA projections are outdated.

The USPS's base year estimates are inaccurate.

In the DFA, USPS projected total mail and package volume would decline over 10.2% from FY2020 to FY2021 in its Base Case scenario.[2] This steep decline was too pessimistic. Before the DFA was implemented, total mail and package volume had declined, on average, 1.9% annually, excluding the pandemic, and 3.4% for all years during FY2015-20.

The USPS FY2021 volume estimate is the base year for the 10-year forecast and is critical to the revenue calculations—an inaccurate base year results in an erroneous projection. In FY2021, the actual mail and package volume for all products was 128.9 billion, nearly 13 billion higher than projected (a 0.2% decline from FY2020 compared to the 10.2% decline projected). As a result, the FY2022 projection is also significantly off; total volume declined 1.2% to 127.3 billion pieces, nearly 14 billion pieces higher than the DFA projection. (Figure 1).

Figure 1.
Total USPS Mail and Package Volume FY2020-22 (Billions)[3]



[2] The "Base Case" scenario is the 10-year financial projection in the DFA used to illustrate the USPS's financial condition under status quo (i.e., without the DFA's added operational efficiencies, additional rate authority, competitive product growth, and restructuring of retiree liability funding requirements); USPS. 2021. Delivering for America.
[3] USPS. 2021. Delivering for America; USPS. Quarterly Statistics Reports.

Market dominant mail fueled USPS revenue gains in FY2021-22 without excessive rate increases, contributing to better-than-projected financial performance.

The DFA seeks revenue improvements by implementing above CPI rate increases for market dominant products and higher volume for competitive products. (Table 1). Our prior research found that most of the DFA's initiatives align with the USPS's vision and mission, but raising rates above CPI does not.[4] This action ultimately hurts, not helps, USPS customers and the USPS's bottom line.

Table 1.
Summary of DFA Revenue Improvement Initiatives[5]

Initiative	Key Elements	FY21 – FY30 Financial Impact
COMPETITIVE REVENUE GROWTH	• Offer innovative commercial services to grow package volumes. • Leverage assets to expand digital and government services. • Identify opportunities for margin improvement. • Align pricing zones to distance traveled.	**$19B – $29B**
MARKET DOMINANT PRICE INCREASE	• Implement authority under PRC price regulations allowing above CPI increases for market dominant and underwater products.	**$35B – $52B**
TOTAL FINANCIAL IMPACT		**$54B – $81B**

FY2021-22 Market Dominant Revenue

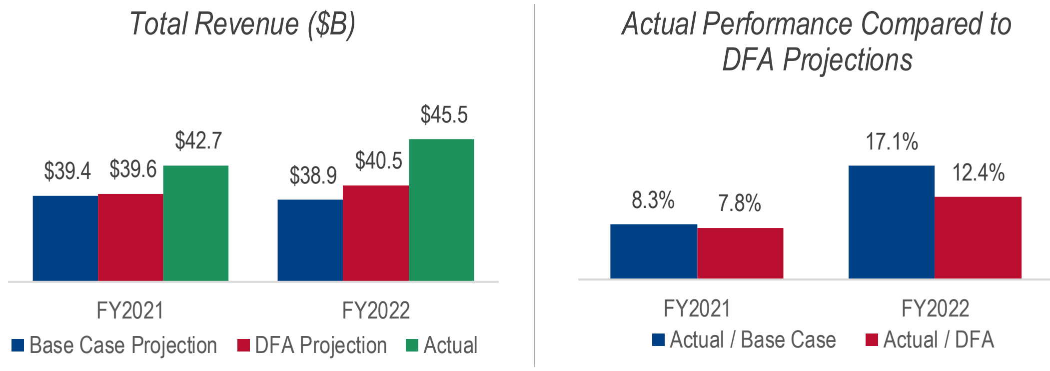
In the first two years of the DFA, market dominant volume performance was a major contributor to higher-than-expected USPS revenue, reinforcing the position that retaining mail volume is vital to the financial stability of the USPS.

In FY2021, market dominant revenue was $42.7 billion, surpassing both the USPS Base Case and DFA projections by $3.3 billion and $3.1 billion, respectively. In other words, actual revenue was 8.3% higher than the Base Case estimate for the first year of its DFA projection and 7.8% higher than the DFA estimate. (Figure 2).

The following year, in FY2022, market dominant revenue was $45.5 billion, exceeding the USPS Base Case and DFA projections by $6.6 billion and $5.0 billion, respectively. So, in the second year of the DFA, actual revenue exceeded USPS projections by 17.1% for the Base Case and 12.4% for the DFA. (Figure 2).

[4] Pham, Nam and Mary Donovan. 2021. "Achieving Financial Stability Without Excessive Rate Increases: A Review of the USPS Strategic Plan "Delivering for America." ndp | analytics.
[5] USPS. 2021. Delivering for America, p. 47.

Figure 2.
USPS Revenue for Market Dominant Products, FY2021-22[6]



The performance of market dominant mail during this period challenges the USPS's assertion that above CPI price increases are needed to generate enough revenue. Instead, preserving as much volume as possible strongly supports the long-term financial stability of the USPS.

As part of the DFA's revenue improvement initiatives, the USPS estimates that above CPI rate increases would allow it to generate an additional $35 billion to $52 billion over 10 years, including $1.8 billion during the first two years (FY2021-22).[7] However, in the first two years of the DFA, the higher-than-projected market dominant volume contributed to a $9.9 billion revenue improvement over the Base Case ($3.3 billion in FY2021 and $6.6 billion in FY2022), accounting for between 19% and 28% of the total expected benefit of raising rates over 10 years. This illustrates that preserving volume can generate meaningful revenue for the USPS. (Table 2).

Table 2.
Unexpected Market Dominant Revenue Compared to DFA Revenue Improvement Expectations[8]

USPS DFA Revenue Improvement Initiative: Market Dominant Price Increase, Over 10 Years, FY2021-30	DFA Projected Revenue Improvement Over Base Case, FY2021-22	Actual Revenue Improvement Over Base Case, FY2021-22
	$1.8 billion	**$9.9 billion**
Low estimate: $35 billion	5.1%	28.3%
Midpoint: $43.5 billion	4.1%	22.8%
High estimate: $52 billion	3.5%	19.1%

[6] USPS. 2021. Delivering for America; USPS. Quarterly Statistics Reports.
[7] USPS. 2021. Delivering for America.
[8] USPS. 2021. Delivering for America; USPS. Quarterly Statistics Reports.

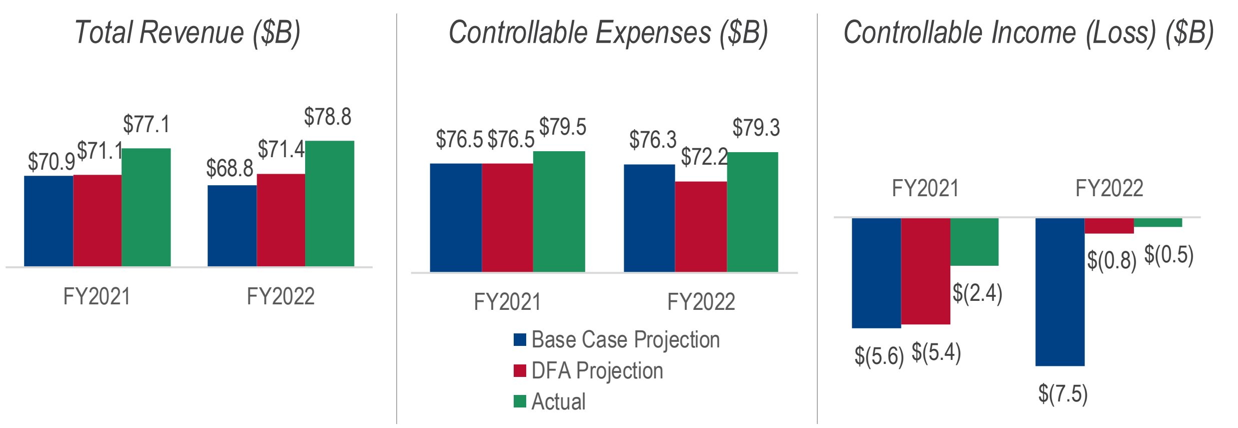
Impact on USPS Financial Position

In the first two years of the DFA, USPS controllable income outperformed expectations. Controllable income is a financial measure reported by the USPS which excludes personnel expenses out of their control (i.e., Federal Employee Retirement System and Civil Service Retirement System unfunded liability amortization payments, and non-cash adjustments to workers' compensation liabilities).

Better-than-projected revenue contributed to improved controllable income for the USPS, despite rising costs. Total revenue from market dominant and competitive products was $77.1 billion in FY2021 and $78.8 billion in FY2022. With rising personnel costs and inflation, USPS controllable expenses reached $70.5 billion in FY2021 and $79.3 billion in FY2023. While controllable expenses overran the Base Case and DFA projections, the overall outcome was significantly better than expected.

In FY2021, the controllable loss was $3 billion better than projected: $2.4 billion compared to $5.4 billion projected under the DFA, and $5.6 billion under the Base Case. In FY2022, the USPS posted a controllable loss of $0.5 billion, compared to $0.8 billion projected under the DFA, and $7.5 billion under the Base Case. (Figure 3).

Figure 3.
USPS Controllable Income (Loss), FY2021-22



Note: Controllable income (loss) is a non-GAAP measure reported by the USPS which is calculated by excluding Federal Employee Retirement System and Civil Service Retirement System unfunded liability amortization payments and non-cash adjustments to workers' compensation liabilities.[9]

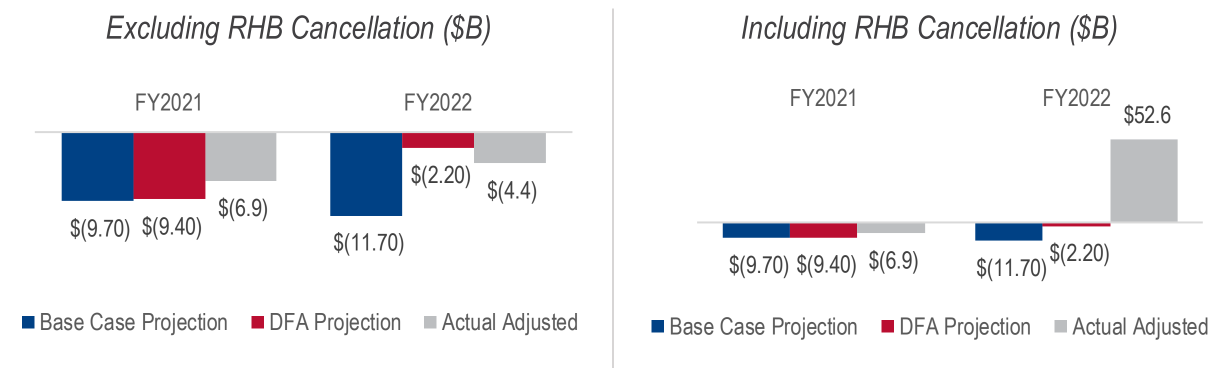
Notably, the overall financial position of the USPS has drastically improved. A huge success for the USPS was Congressional action in 2022 to erase $57 billion in accrued unpaid retiree health benefits. However, the Postal Regulatory Commission ("PRC") has allowed the USPS to exclude this massive change from their regulatory financials in FY2022.[10] This PRC action enabled the USPS to have greater rate authority in

[9] USPS. 2022. FY2023 Integrated Financial Plan.
[10] PRC. 2023." Order on Analytical Principles Used in Periodic Reporting (Proposal Seven)." Docket No. RM2023-2. March 17.

FY2023. While the additional authority is intended to help the USPS achieve financial stability, the USPS's request to ignore such a major improvement in its financial position suggests it intends to maximize its authority to customer rates as much and as frequently as possible.

With the exclusion of the canceled retiree health benefit obligations from its regulatory financials, the USPS posted an adjusted loss of $4.4 billion in FY2022 instead of $52.6 billion of income (adjusted to exclude non-cash workers' compensation which is not part of DFA projections). This loss is $2.2 billion greater than the DFA projection and a $7.3 billion improvement over the Base Case. (Figure 4).

Figure 4.
USPS Net Income (Loss), FY2021-22



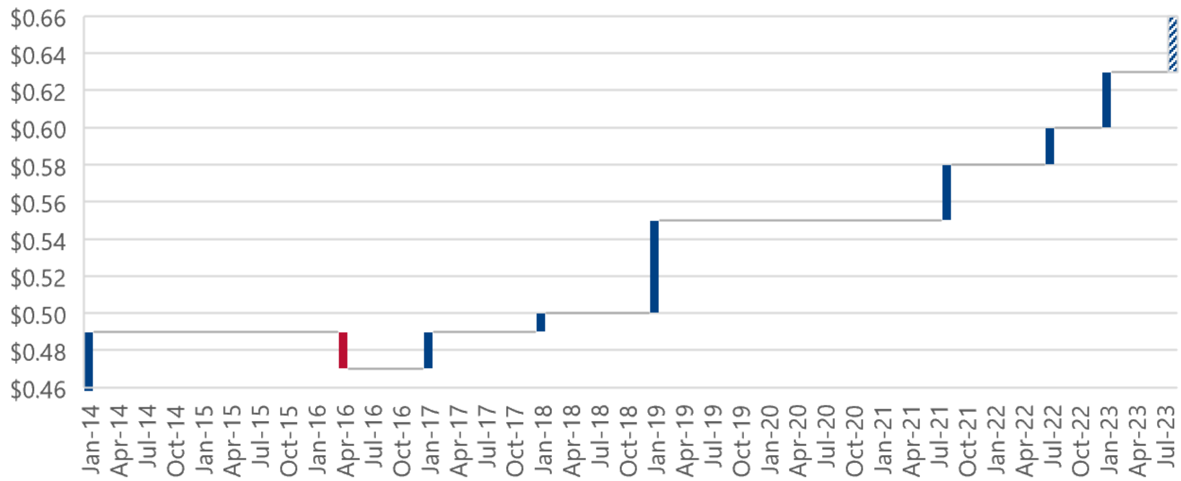
Note: "Actual Adjusted" excludes non-cash adjustments to workers' compensation liabilities which are not included in DFA projections.

After back-to-back increases under the DFA, FY2023 market dominant mail volume declines are accelerating, compromising USPS revenue and overall financial stability.

After a series of rate increases, FY2023 market dominant volume decline is accelerating. During the first two years of the DFA, market dominant mail outperformed USPS expectations, generating more revenue than projected with minimal volume declines. Now, the trend seems to have abruptly reversed.

Since 2021, the USPS has raised rates several times. Using stamps as an example, the first-ounce rate for First Class domestic letters rose from $0.55 to $0.58 in August 2021. Then, in July 2022, it increased to $0.60, and $0.63 in January 2023. The USPS has proposed to increase rates again, to $0.66 in the summer of 2023. Before the DFA, rates had remained stable after a steep increase of $0.05 in January 2019. (Figure 5).

Figure 5.
First Class Domestic Letter Rates (First Ounce)[11]



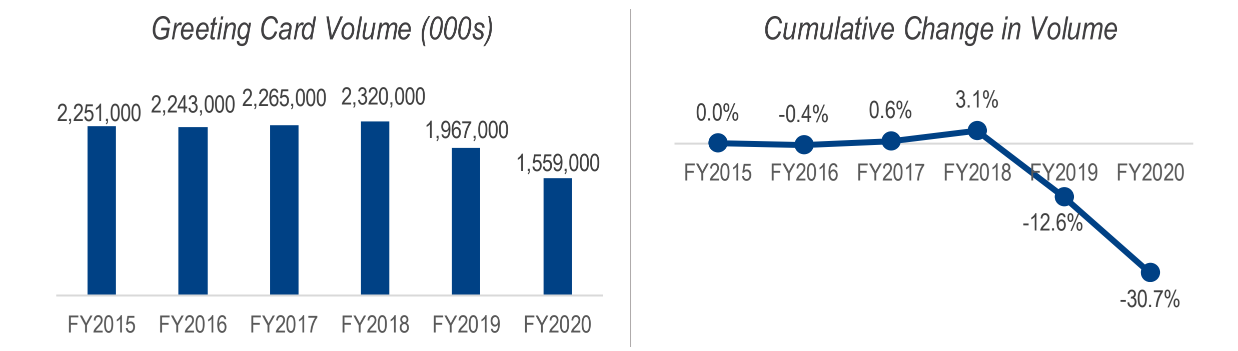
*July 2023 is the proposed rate increase.

Semiannual rate increases, like the ones seen in the past few years, have not been used in the past. Like many other products, the frequency or magnitude of price changes can impact customers' behavior. Indeed, many types of mail share characteristics of more elastic products and can make consumers sensitive to price increases. For example, substitutes for some types of mail are easily accessible, for example, e-mail and online bill pay. These substitutes are often low-cost or free, and businesses and consumers can migrate to alternative options over the short- to medium-term. Therefore, it's not unrealistic that semiannual above-CPI price increases have pushed some USPS customers to reduce mail volume or replace it altogether.

The impact of the five-cent stamp increase in 2019 on greeting cards provides a strong case study of how USPS customers are price-sensitive. USPS marketing efforts and moderate rate increases historically contributed to relatively stable household mail volumes. Greeting card volume was even on the rise leading up to 2019. But, after stamp prices rose 10% from $0.50 to $0.55 in 2019, volume sharply declined by 12.6% and continued to decrease the following year. (Figure 6).

[11] USPS. Rates for Domestic Letters. Available: https://about.usps.com/who/profile/history/domestic-letter-rates-since-1863.htm (accessed April 2023); USPS. 2023. "U.S. Postal Service Files Notice with PRC for New Mailing Services Pricing." April 10.

Figure 6.
Greeting Card Volume, FY2015-20[12]



USPS demand models show that market dominant mail products are inelastic. However, these models are unreliable and potentially unfit for predictive purposes because they are overfitted and change frequently, making it difficult to test their accuracy.[13] For illustrative purposes, we use the basic price elasticity formula to examine expected volume loss due to the stamp price increase based on USPS elasticity calculations.[14]

In 2019, the USPS elasticity coefficient for single-piece letters was -0.19, meaning that a 1% increase in price results in a 0.19% decrease in volume.[15] So, the USPS elasticity estimate would predict a 1.9% decline in volume due to a 10% increase in postage ($0.50 to $0.55).

The actual volume decline was much worse. Greeting card volume dropped by 353 million pieces from FY2018 to FY2019. The USPS elasticity models did not predict such a significant decline. According to USPS estimates, volume loss attributable to the 10% price increase was only 44.1 million pieces (1.9% decline from 2.3 million pieces in FY2018); the remaining loss of 308.9 million pieces would have to have been attributable to other factors. Yet, based on our past research, the 2019 decline in greeting cards does not appear to be explained by economic factors or consumer behavior changes from the electronic diversion.[16] Indeed, consumers are likely more sensitive to changes in price than the USPS elasticity model suggests.

Year-to-Date Performance

After the back-to-back rate increases, mail volume is significantly underperforming compared to prior years. From October to March FY2023, mail volume declined by 6.9% compared to the same period in FY2022. In comparison, the average annual rate of decline during the first half of the fiscal year was 2.4% during FY2018-

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[12] Pham, Nam D., Ph.D. and Mary Donovan. 2021. “Achieving Financial Stability Without Excessive Rate Increases: A Review of the USPS Strategic Plan “Delivering for America.” ndp analytics.
[13] ndp analytics analysis of USPS demand equations; USPS. Postal Service Econometric Estimates of Demand Elasticity for All Postal Products.
[14] Price elasticity equals the percent change in quantity divided by the percent change in price.
[15] USPS. 2020. Econometric Demand Equation Tables for Market Dominant Products as of January 2020.
[16] Pham, Nam D., Ph.D. and Mary Donovan. 2021. “Achieving Financial Stability Without Excessive Rate Increases: A Review of the USPS Strategic Plan “Delivering for America.” ndp analytics.

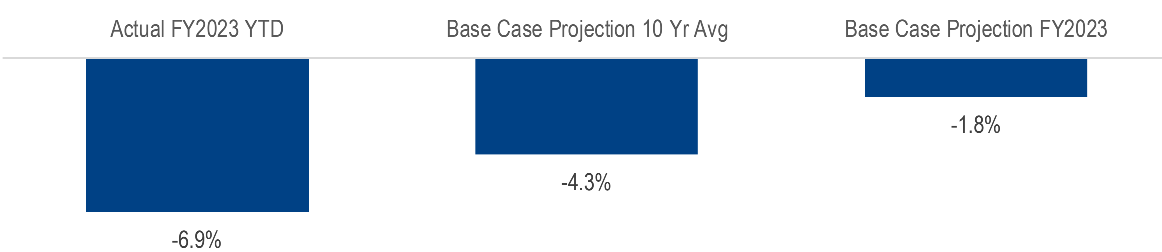
22, excluding the pandemic (3.2% for all years). For market dominant products, the current rate of decline is 7.1% compared to an average of -2.3% excluding the pandemic (-3.4% for all years). (Table 3).

Table 3.
March Year-to-Date Volume Performance Compared to Prior Five Years[17]

	FY2023 March YTD vs. SPLY	Average YOY Change as of March (FY2018-22)	Average YOY Change as of March ex Covid (FY2018-22)
All Mail	**-6.9%**	**-3.2%**	**-2.4%**
Market Dominant	**-7.1%**	**-3.4%**	**-2.3%**
First Class	-6.3%	-3.4%	-2.7%
Periodicals	-10.8%	-8.5%	-7.6%
Marketing	-7.6%	-3.3%	-2.1%
Competitive Mail	**-3.6%**	**4.0%**	**-2.1%**

Current volume declines are more severe than predicted in the DFA. Over the 10-year implementation period, the DFA projects that average total mail volume will decline by 4.3% per year under its Base Case. Volume declines for the current year were expected to be modest; the USPS projected a year-over-year decline of 1.8% from FY2022 to FY2023.[18] At the current pace, the actual volume decline for FY2023 will be much steeper than anticipated in the DFA.[19] (Figure 7).

Figure 7.
Current and Projected Total Mail Volume Performance Year-Over-Year[20]



[17] USPS. Monthly Preliminary Financial Statements (Unaudited). "Ex Covid" excludes the year-over-year change from FY2020 to FY2021. "SPLY" is "Same Period Last Year".
[18] The DFA did not publish projected volumes by product category, nor total volume figures. The report says that the USPS analysis "incorporate[s] volume losses, due to increased prices based on estimated price elasticities." USPS. 2021. Delivering for America, p. 46.
[19] Our current volume projection for FY2023 are about 119B pieces for mail and packages combined, a 6.7% decline from FY2023.
[20] USPS. 2021. Delivering for America; USPS. Monthly Preliminary Financial Statements (Unaudited).

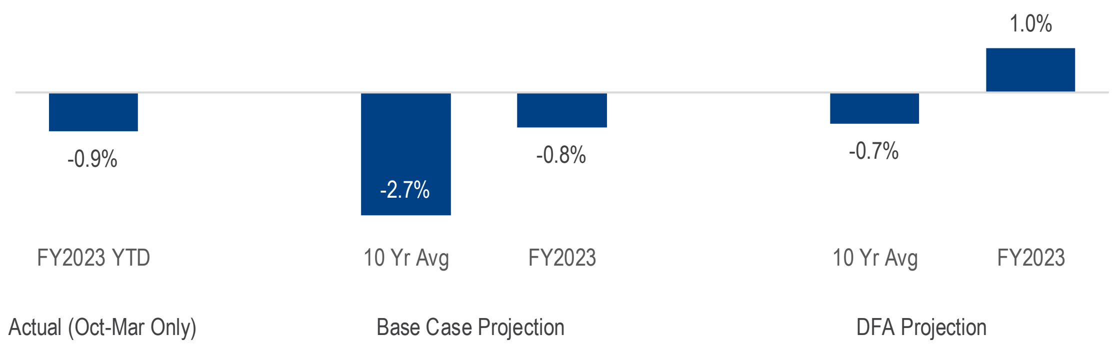
A critical component of the DFA is growing revenue. However, FY2023 revenue is underperforming compared to prior years. Year-to-date market dominant revenue is 0.9% lower than last year (October to March). In the past, revenue for this category has grown at an average annual rate of 0.6% during the first six months of the fiscal year, excluding the pandemic (-0.7% for all years). (Table 4).

Table 4.
March Year-to-Date Revenue Performance Compared to Prior Five Years[21]

	FY2023 March YTD vs. SPLY	Average YOY Change as of March (FY2018-22)	Average YOY Change as of March ex Covid (FY2018-22)
All Mail	**-0.7%**	**2.4%**	**0.9%**
Market Dominant	**-0.9%**	**-0.7%**	**0.6%**
First Class	1.0%	-1.4%	-0.6%
Marketing	-3.2%	-0.9%	1.2%
Periodicals	-3.7%	-7.2%	-5.6%

The market dominant revenue is falling behind DFA expectations. Over the course of the DFA, the USPS projected an average decline of 0.7%. To date, FY2023 revenue has already declined by 0.9%. The DFA is even further off comparing FY2023 performance to the DFA projection for FY2023 alone. This year, the DFA expected a revenue increase of 1.0%; instead, it is declining. (Figure 8).

Figure 8.
Current and Projected Market Dominant Revenue Growth Year-Over-Year[22]

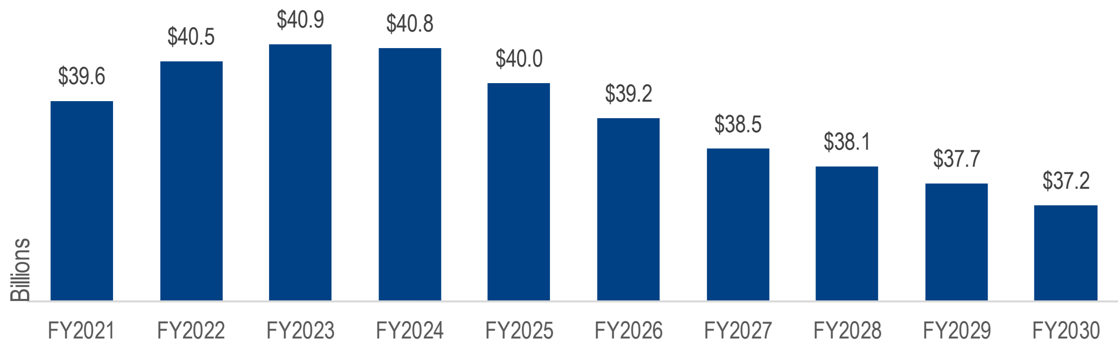


Notably, DFA projections expected market dominant mail to generate its maximum revenue level in FY2023. For the remainder of the DFA, the USPS projects declining revenue. In other words, even with semiannual above CPI rate increases, the DFA does not expect to be able to grow market dominant revenue past FY2023. (Figure 9).

[21] USPS. Monthly Preliminary Financial Statements (Unaudited). "Ex Covid" excludes the year-over-year change from FY2020 to FY2021.

[22] USPS. 2021. Delivering for America; USPS. Monthly Preliminary Financial Statements (Unaudited).

Figure 9.
USPS Market Dominant Mail Revenue Projection for DFA[23]



Competitive products have not grown as expected in FY2023.

The DFA has a strong focus on package growth; it expects to generate a revenue improvement of $19 billion to $29 billion from volume growth over 10 years and plans to invest heavily in processing infrastructure as part of its commitment to invest $40 billion on improvements.[24] Unlike market dominant products, where the USPS was too pessimistic in its volume expectations, the DFA outlook for competitive products may have been too optimistic. Furthermore, it appears that revenue from market dominant products will be used to invest in competitive products.

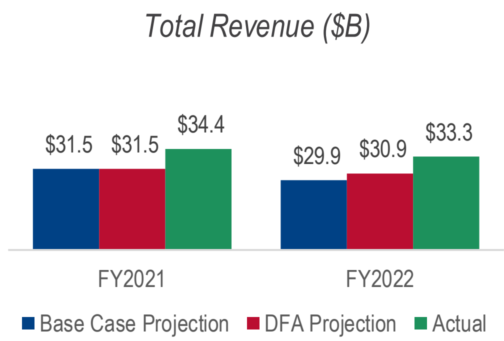
In FY2021 and FY2022, competitive product volume and revenue benefited from increased activity following the COVID-19 pandemic. However, this category now lags behind expectations. Despite underperforming, the USPS has lowered competitive product rates while raising rates for First Class mail.[25] In its most recent rate filing, the new USPS "Ground Advantage" products (previously First-Class Package Services) are set to decrease by 3.2% for retail and 0.7% for commercial prices.[26]

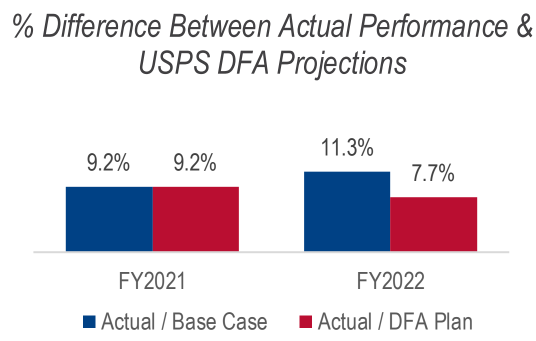
Effective July 2023, the USPS will generate less revenue per piece while volume is declining from the prior year. At the same time, the USPS is investing heavily in its package processing infrastructure as part of the DFA's commitment to self-fund $40 billion on in improvements.[27] Since the DFA's implementation, USPS daily processing capacity has increased to 60 million packages per day.[28] Given this series of actions—raising market dominant rates, lowering competitive rates while volume growth lags, and investing heavily in package processing—it appears that revenue captured in the short term from market dominant rate hikes will be used to fund DFA investments on competitive products.

[23] USPS. 2021. Delivering for America.
[24] USPS. 2021. Delivering for America.
[25] USPS. 2023. U.S. Postal Service Files Notice with PRC for New Mailing Services Pricing. April 10.
[26] USPS. 2023. USPS Notice of Changes in Rates and Classifications of General Applicability for Competitive Products (May 10, 2023). Docket No. CP2023-151.
[27] USPS. 2021. Delivering for America.
[28] USPS. 2023. Delivering for America – Second Year Progress Report.

In the first two years of the DFA, competitive products followed a similar pattern as market dominant products, with higher revenue driven by increased package demand following the COVID-19 pandemic.[29] In FY2021, competitive mail revenue was $34.4 billion, $2.9 billion (9.2%) higher than Base Case and DFA projections. In FY2022, actual revenue for this category was $33.3 billion, surpassing the Base Case and DFA projections by $3.4 billion and $2.4 billion, respectively. For that year, USPS projections for competitive products underestimated revenue by 11.3% for the Base Case and 7.7% for the DFA. (Figure 10).

Figure 10.
USPS Revenue for Competitive Products, FY2021-22[30]





However, in FY2023 competitive product volume is now underperforming compared to prior years. To date, competitive products have experienced a 3.6% decline in volume compared to last year. The current volume decline is more severe than in the past, where the year-over-year decline for this period (October-March) was 2.1%, excluding the pandemic (4.0% growth for all years). (Table 5).

Table 5.
March Year-to-Date Volume Performance Compared to Prior Five Years[31]

	FY2023 March YTD vs. SPLY	Average YOY Change as of March (FY2018-22)	Average YOY Change as of March ex Covid (FY2018-22)
All Mail	**-6.9%**	**-3.2%**	**-2.4 %**
Competitive Products	**-3.6%**	**4.0%**	**-2.1%**

[29] USPS. Integrated Financial Plan FY2022.
[30] USPS. 2021. Delivering for America; USPS. Quarterly Statistics Reports.
[31] USPS. Monthly Preliminary Financial Statements (Unaudited). "Ex Covid" excludes the year-over-year change from FY2020 to FY2021. "SPLY" is "Same Period Last Year"

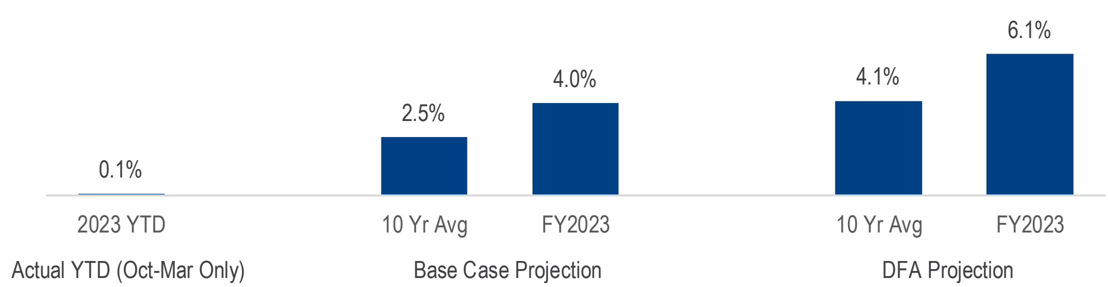
Lower-than-expected volume for competitive products has contributed to underperforming revenue compared to prior years. Year-to-date revenue has grown by 0.1% from last year (October-March). This figure lags behind the average annual growth rate over the past five years, 3.3%, excluding the pandemic. (Table 6).

Table 6.
March Year-to-Date Revenue Performance Compared to Prior Five Years[32]

	FY2023 March YTD vs. SPLY	Average YOY Change as of March (FY2018-22)	Average YOY Change as of March ex Covid (FY2018-22)
All Mail	**-0.7%**	**2.4%**	**0.9%**
Competitive Mail	**0.1%**	**10.2%**	**3.3%**

Halfway through FY2023, competitive revenue is only 0.1% higher than the previous year. In the DFA, both the Base Case and DFA projections expect greater revenue growth from this category. Over the course of the DFA, the USPS expected 2.5% annual revenue growth, on average, for this category in its Base Case and 4.1% in its DFA projections. For FY2023 alone, the USPS expected 4.0% growth under its Base Case and 6.1% under the DFA. (Figure 11).

Figure 11.
Current and Projected Competitive Product Revenue Performance Year-Over-Year[33]



Past performance indicates that the USPS will likely not reach its revenue target for competitive products in FY2023. Historically, the year's first six months account for 52.3% of total competitive product revenue.[34] At the halfway mark in FY2023, competitive product revenue was \$16.7 billion.[35] Based on the historical trend, year-end competitive product revenue will likely be around \$31.9 billion, nearly \$1 billion below the DFA target of \$32.8 billion.

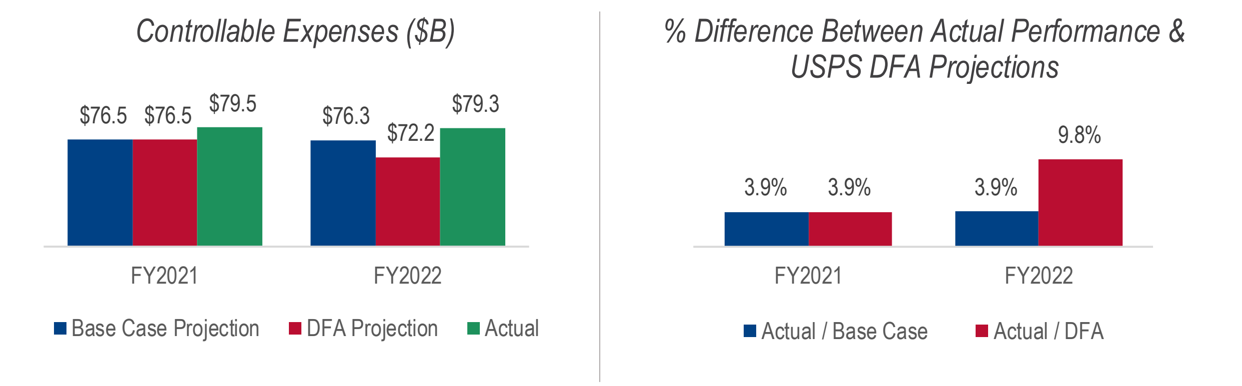
[32] USPS. Monthly Preliminary Financial Statements (Unaudited). "Ex Covid" excludes the year-over-year change from FY2020 to FY2021.
[33] USPS. 2021. Delivering for America; USPS. Monthly Preliminary Financial Statements (Unaudited).
[34] Average share of total revenue since FY2015, excluding the pandemic (FY2020); USPS. Monthly Preliminary Financial Statements (Unaudited).
[35] USPS. Monthly Preliminary Financial Statements (Unaudited).

Efficiencies expected under the DFA have not been realized.

The DFA set out to improve the financial position of the USPS through cost savings from optimization, modernization, consolidation, and other initiatives. Several key elements include optimizing office and street efficiencies, minimizing redundant lanes, and unplanned, late, and extra trips, consolidating operations, and reducing non-transportation contractor spend.[36] It also planned to allocate $40 billion in self-funded improvements over 10 years.[37] To date, the USPS has committed $7.6 billion toward modernizing its network, including new sorting and delivering centers and regional processing and distribution centers.[38]

In FY2021-22, the USPS did not meet its target for controllable costs. During the first year of the DFA, FY2021, controllable costs were $79.5 billion, $3.0 billion higher than the Base Year and DFA projections. In FY2022, controllable costs were $79.3 billion, $3.0 billion (3.9%), and $7.1 billion (9.8%) higher than the USPS Base Case and DFA projections, respectively. (Figure 12).

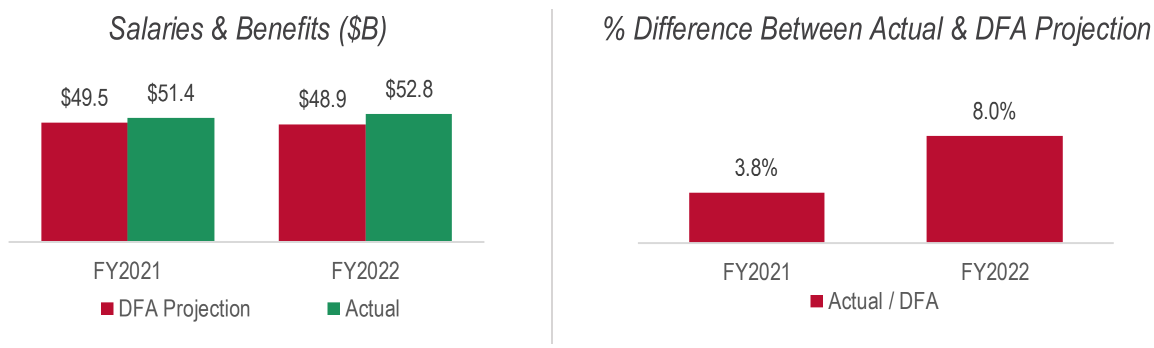
Figure 12.
USPS Controllable Expenses, FY2021-22[39]



Higher-than-expected expenditures were primarily driven by increased labor costs which account for the majority of controllable expenses. In FY2021, salaries and benefits were $1.9 billion higher than DFA projection ($51.4 billion compared to $49.5 billion).[40] In FY2022, the USPS projected that salaries and benefits would decrease to $48.9 billion; instead, they increased to $52.8 billion. The DFA underestimated second-year salaries and benefits by $3.9 billion (8%). (Figure 13).

[36] USPS. 2021. Delivering for America, p. 48.
[37] USPS. 2021. Delivering for America.
[38] USPS. 2023. Delivering for America – Second Year Progress Report.
[39] USPS. 2021. Delivering for America; USPS. 2022. Integrated Financial Plan, FY2023.
[40] The USPS did not publish a salary and benefits projection for its Base Case in the DFA.

Figure 13.
USPS Salary & Benefit Expenses, FY2021-22



Increased labor costs are not directly linked to inflation. According to a 2022 study by the Office of the Inspector General ("OIG"), "[a] primary way that inflation impacts labor costs … is through cost-of-living adjustments ("COLAs") paid to career bargaining unit employees."[41] OIG reported that COLAs typically cover 55%-60% of inflation and apply to career employees only. In FY2022, the USPS estimated an increase of $1.1 billion in its expenses from COLAs, which would only account for a portion of the $3.9 billion gap between the DFA and its actual expenses.[42] Significant contributors to labor costs, like general wages and benefits, are not directly tied to inflation.[43] (Table 7).

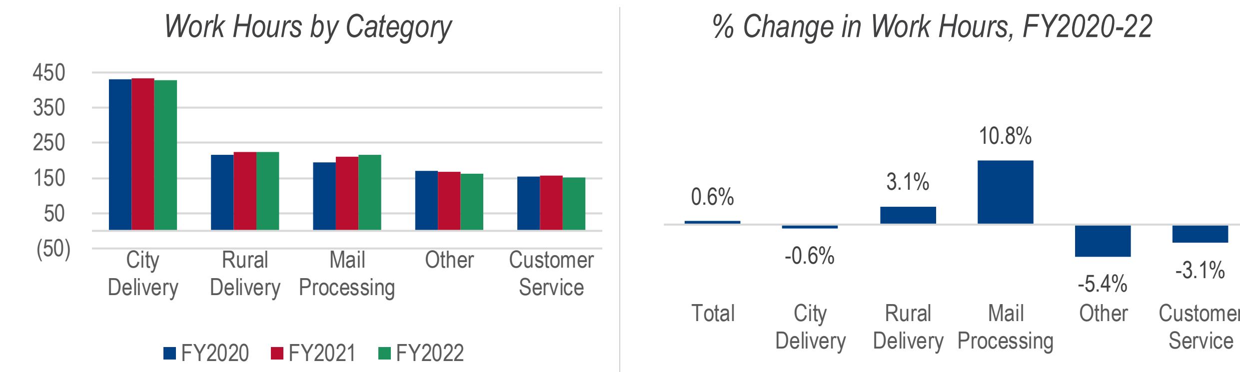
Table 7.
OIG Summary of Impacts of Inflation on Labor Expenses[44]

	Directly tied to an Inflation Index	Immediacy of Impact	Magnitude of Impact
General wage increases for bargaining unit employees	No	CBAs generally cover a three-year period	Depends on outcome of collective bargaining
Salary increases for current career non-bargaining unit employees	No	Salary increases are only based on performance	N/A
Salaries of new career non-bargaining employees	No	Once a year	USPS often use OPM's updated pay bands, which may consider inflation
COLAs for career bargaining unit employees	Yes	Twice a year	Below inflation (CPI-W)
Contribution to employee health care premiums and retirement benefits	No	Annually	Medical inflation is higher than inflation (CPI-U)

[41] OIG. 2022. Inflation and the U.S. Postal Service (RISC-WP-22-008). August 16, p. 1.
[42] USPS increase from COLAs reported in OIG report.
[43] The overrun salary and benefit costs is not explained by general trends of total compensation. Using the BLS Employer Cost Index (ECI), total compensation for workers in the U.S. grew, on average, 2.6% per year for the five years leading up to the DFA implementation. Since then, total compensation rose 3.7% in 2021 (1.1% over historical trend) and 5.0% in 2022 (2.4% over the historical trend).
[44] OIG. 2022. Inflation and the U.S. Postal Service (RISC-WP-22-008). August 16.

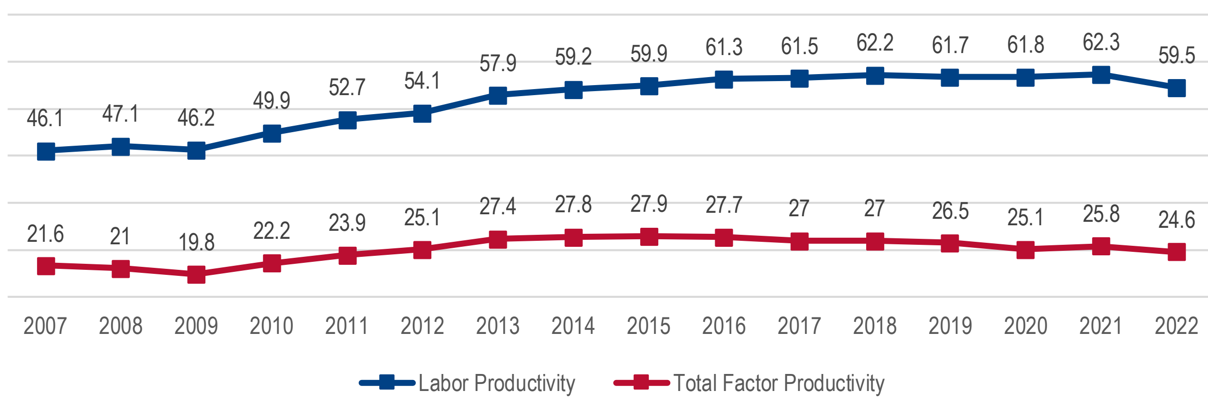
The USPS cost overruns, at least in part, can be attributed to productivity. Even with efficiency improvements and volume declines, total work hours were higher in FY2022 than in FY2020, the year before the DFA was implemented, driven by increased time spent on mail processing.[45] During this period, mail processing work hours grew by 21 million (11%), and total work hours increased by 7 million (0.6%). (Figure 14).

Figure 14.
USPS Work Hours, FY2020-22



Efficiency challenges are also apparent in postal labor and total factor productivity measures. Both have shown a decline since the implementation of the DFA. In FY2022, labor productivity was 59.5, the lowest level since 2014. Total factor productivity was 24.6, the lowest on record since 2011. (Figure 15).

Figure 15.
USPS Labor and Total Factor Productivity, Percent Change by Year Relative to Base Year (FY1971)[46]

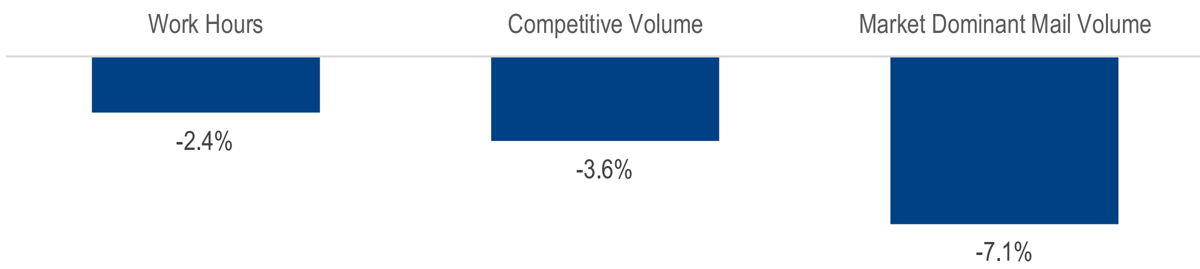


[45] In its update on the DFA, the USPS says "[256 new high-speed package sorting] machines coupled with increased operating precision, increased our daily package processing capacity to 60 million, a capacity of more than 10 million higher than the package volume recorded on our busiest day in the 2022 peak season. Our daily processing capacity currently exceeds the daily number of packages being shipped across the nation;" USPS. 2023. Delivering for America Second Year Progress Report, p. 6.

[46] USPS. FY2022 Annual Report to Congress, p. 50.

Midway through year three of the DFA, labor productivity improvements appear to be minimal. In FY2023, while work hours have started to decline, the magnitude is much less than volume declines, year-to-date. (Figure 16).

Figure 16.
FY2023 Change Year-to-Date [47]



Economic conditions have changed.

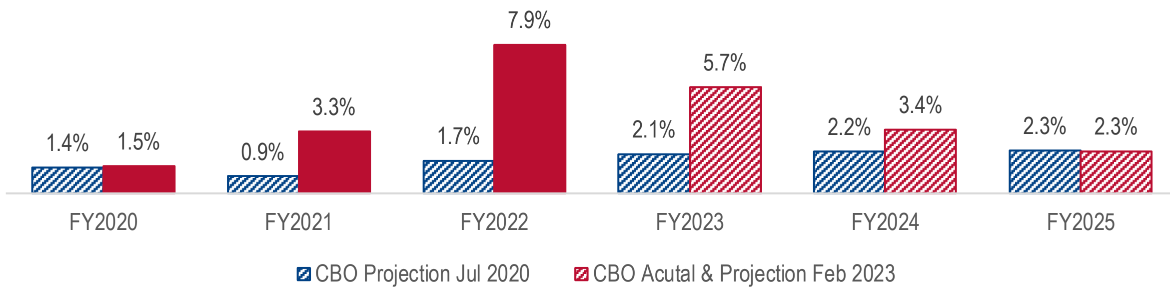
Macroeconomic conditions impact USPS expenses, such as labor and transportation, and its ability to generate revenue through rate setting and customer spending. Additionally, OIG recognizes the impact of economic conditions on volume, stating "if a recession follows the current period of high inflation, the overall economic distress would likely impact volumes."[48] The economic projections from 2020 vary widely from the actual and current projections. To illustrate how expectations have changed, we compared the Congressional Budget Office ("CBO")'s projections from July 2020 and February 2023 for inflation, gross domestic product ("GDP"), personal consumption expenditures, and unemployment. Also included are the survey findings from the Wall Street Journal on the probability of a recession.

Inflation

Inflation is likely the most significant economic factor underestimated in the DFA. At the time the DFA was developed, inflation projections were stable. The CBO projected in 2020 that inflation would hover around 2% or lower from FY2020 to FY2025. Actual inflation has been much more significant, reaching 7.9% in 2022. The CBO does not expect inflation to get back to the 2% range until FY2025. (Figure 17).

[47] USPS. Monthly Preliminary Financial Statements (Unaudited).
[48] OIG. 2022. Inflation and the U.S. Postal Service (RISC-WP-22-008). August 16, p. 15.

Figure 17.
CBO Inflation Projections in July 2020 and February 2023 [49]

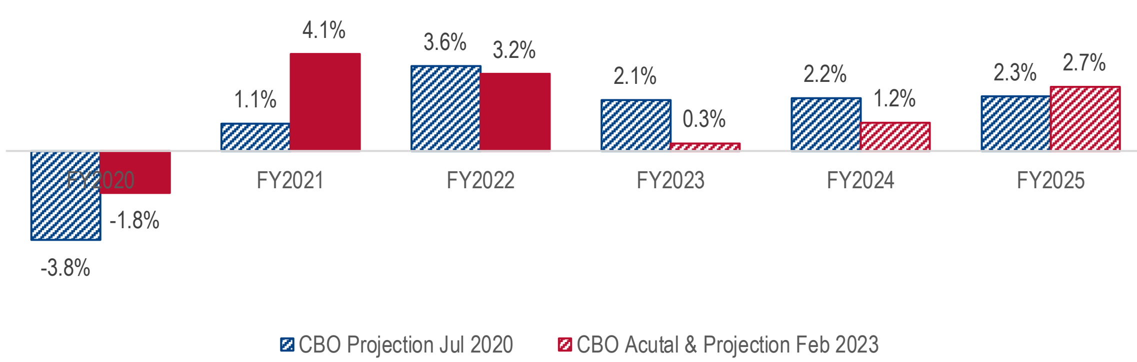


The DFA relied on inflation to project market dominant rates, and, subsequently, revenue over the 10 years from FY2021 to FY2030. The DFA also relied on relatively stable inflation to estimate future labor, transportation, and supplies costs, all of which have gone up significantly since the DFA was developed. Additionally, USPS customers are also impacted by inflation; households and businesses feel the pressure for higher prices, which can prompt changes in spending behavior.

GDP

In 2020, GDP is expected to rebound from the COVID pandemic and remain in the range of 2.1% to 3.6% during FY2022-25. Instead, the economy initially rebounded faster than expected. However, in FY2023, CBO expects growth to decline to 0.3%, in contrast to the 2.1% it had projected for this period back in July 2020. (Figure 18).

Figure 18.
CBO GDP Projections in July 2020 and February 2023 [50]

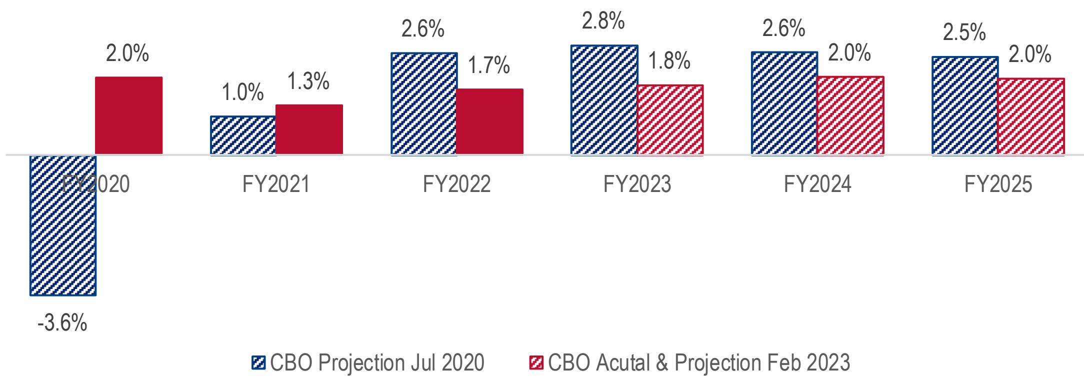


49 CBO. Jul 2020 Baseline Forecast (Fiscal Year); CBO. Feb 2023 Baseline Forecast (Fiscal Year).
50 CBO. Jul 2020 Baseline Forecast (Fiscal Year); CBO. Feb 2023 Baseline Forecast (Fiscal Year).

Personal Consumption Expenditures

In 2020, personal consumption expenditures were expected to rebound from the COVID pandemic and remain in the range of 2.5% to 2.8%. In FY2022, actual expenditures were only 1.7%. Now CBO is projecting more modest growth, ranging from 1.8% to 2.0% through FY2025. (Figure 19).

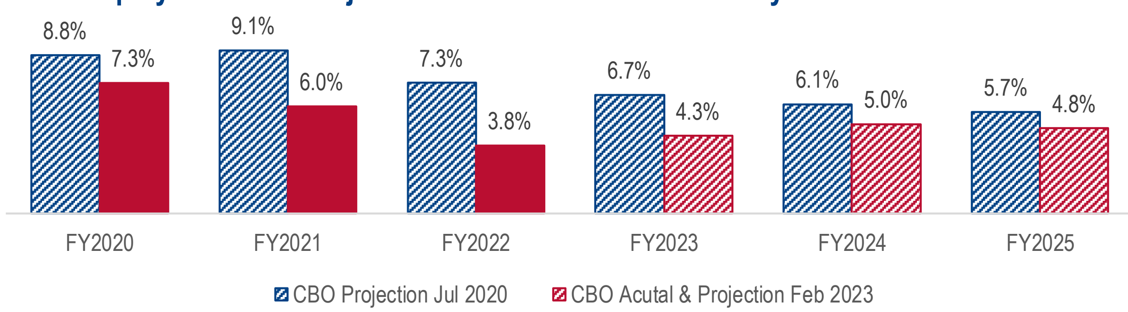
Figure 19.
CBO Personal Consumption Expenditure Projections in July 2020 and February 2023 [51]



Unemployment

In 2020, the unemployment rate was expected to range from 5.7% to 9.1%. However, the unemployment rate has been lower than expected, lowering to 3.8% in FY2023. CBO now expects it to stay at or below 5% through FY2023. (Figure 20).

Figure 20.
CBO Unemployment Rate Projections in June 2020 and February 2023 [52]

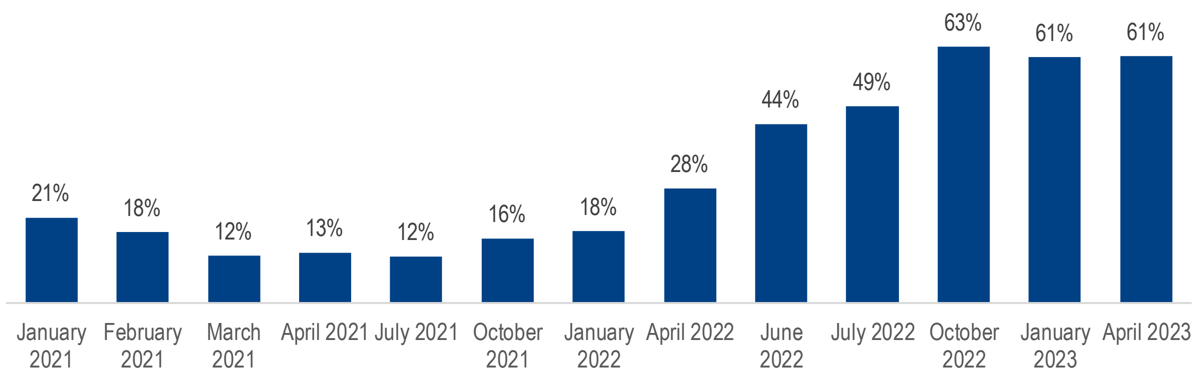


[51] CBO. Jul 2020 Baseline Forecast (Fiscal Year); CBO. Feb 2023 Baseline Forecast (Fiscal Year).
[52] CBO. Jul 2020 Baseline Forecast (Fiscal Year); CBO. Feb 2023 Baseline Forecast (Fiscal Year).

Probability of Recession

The probability of a recession has greatly increased over the last few years. The most recent Wall Street Journal Economic Survey found that the likelihood of a recession was 61%, up from 21% in January 2021. (Figure 21).

Figure 21.
WSJ Economic Survey: Probability of a Recession in the Next 12 Months[53]



Conclusion

The DFA is outdated. Nearly a third of the way through its 10-year timeline, the USPS has not achieved expected efficiencies and package growth. In many ways, the USPS is more financially stable. This is driven more by the Congressional approval to erase nearly $57 billion in unpaid retiree health benefit obligations (despite PRC approval to exclude it from the financials) and better-than-expected market dominant mail performance. The DFA's market dominant projection was far too pessimistic and, consequently, does not serve as a useful benchmark for estimating future revenue. While the USPS has an opportunity to capitalize on the category's higher-than-expected volume and subsequent revenue gains, it still opts to implement semiannual above-CPI rate increases. This approach is not improving the USPS's financial stability. After back-to-back increases, volume declines are starting to accelerate, compromising the revenue contribution of market dominant products. The DFA's approach to ratemaking has contributed to an overall revenue loss for market dominant products to date in FY2023, compared to last year. With a higher probability of a recession, future mail volume and, consequently, revenue are more at risk.

[53] WSJ Economic Survey April 2023.

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