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## The U.S. Postal Service Nears Collapse

Delivery of first-class mail is falling at a staggering rate. Facing insolvency, can the USPS reinvent itself like European services have—or will it implode?

By [Devin Leonard](#)

Phillip Herr looks like many of the men who toil deep within the federal government. He wears blue suits. He keeps his graying hair and mustache neatly trimmed. He has an inoffensively earnest manner. He also has heavy bags under his eyes, which testify to the long hours he spends scrutinizing federal spending for the U.S. Government Accountability Office, the congressional watchdog agency where he is Director of Physical Infrastructure Issues. As his title suggests, Herr devotes much of his time to highway programs. But for the past three years he has been diagnosing what ails the U.S. Postal Service.

It's a lonely calling. "Washington is full of Carnegie and Brookings Institutes with people who can tell you every option we have in Egypt or Pakistan," laments Herr, who has a PhD in anthropology from Columbia University. "Try and find someone who does that on the postal service. There aren't many."

Yet Herr finds the USPS fascinating: ubiquitous, relied on, and headed off a cliff. Its trucks are everywhere; few give it a second thought. "It's one of those things that the public just takes for granted," he says. "The mailman shows up, drops off the mail, and that's it."

He is struck by how many USPS executives started out as letter carriers or clerks. He finds them so consumed with delivering mail that they have been slow to grasp how swiftly the service's financial condition is deteriorating. "We said, 'What's your 10-year plan?'" Herr recalls. "They didn't have one."

Congress gave him until the end of 2011 to report on the USPS's woes. But Herr and his team concluded that the postal service's business model was so badly broken that collapse was imminent. Abandoning a long tradition of overdue reports, they felt they had to deliver theirs 18 months early in April 2010 to the various House and Senate committees and subcommittees that watch over the USPS. A year later, the situation is even grimmer. With the rise of e-mail and the decline of letters, mail volume is falling at a staggering rate, and the postal service's survival plan isn't reassuring. Elsewhere in the world, postal services are grappling with the same dilemma—only most of them, in humbling contrast, are thriving.

The USPS is a wondrous American creation. Six days a week it delivers an average of 563 million pieces of mail—40 percent of the entire world's volume. For the price of a 44¢ stamp, you can mail a letter anywhere within the nation's borders. The service will carry it by pack mule to the Havasupai Indian reservation at the bottom of the Grand Canyon. Mailmen on snowmobiles take it to the wilds of Alaska. If your recipient can no longer be found, the USPS will return it at no extra charge. It may be the greatest bargain on earth.

It takes an enormous organization to carry out such a mission. The USPS has 571,566 full-time workers, making it the country's second-largest civilian employer after Wal-Mart Stores ([WMT](#)). It has 31,871 post offices, more than the combined domestic retail outlets of Wal-Mart, Starbucks ([SBUX](#)), and McDonald's ([MCD](#)). Last year its

revenues were \$67 billion, and its expenses were even greater. Postal service executives proudly note that if it were a private company, it would be No. 29 on the Fortune 500.

The problems of the USPS are just as big. It relies on first-class mail to fund most of its operations, but first-class mail volume is steadily declining—in 2005 it fell below junk mail for the first time. This was a significant milestone. The USPS needs three pieces of junk mail to replace the profit of a vanished stamp-bearing letter.

During the real estate boom, a surge in junk mail papered over the unraveling of the postal service's longtime business plan. Banks flooded mailboxes with subprime mortgage offers and credit-card come-ons. Then came the recession. Total mail volume plunged 20 percent from 2006 to 2010.

Since 2007 the USPS has been unable to cover its annual budget, 80 percent of which goes to salaries and benefits. In contrast, 43 percent of FedEx's ([FDX](#)) budget and 61 percent of United Parcel Service's ([UPS](#)) pay go to employee-related expenses. Perhaps it's not surprising that the postal service's two primary rivals are more nimble. According to SJ Consulting Group, the USPS has more than a 15 percent share of the American express and ground-shipping market. FedEx has 32 percent, UPS 53 percent.

The USPS has stayed afloat by borrowing \$12 billion from the U.S. Treasury. This year it will reach its statutory debt limit. After that, insolvency looms.

On Mar. 2, Postmaster General Patrick R. Donahoe warned Congress that his agency would default on \$5.5 billion of health-care costs set aside for its future retirees scheduled for payment on Sept. 30 unless the government comes to the rescue. "At the end of the year, we are out of cash," Donahoe said. He noted that the unusual requirement was enacted five years ago by Congress before mail started to disappear.

This should be a moment for the country to ask some basic questions about its mail delivery system. Does it make sense for the postal service to charge the same amount to take a letter to Alaska that it does to carry it three city blocks? Should the USPS operate the world's largest network of post offices when 80 percent of them lose money? And is there a way for the country to have a mail system that addresses the needs of consumers who use the Internet to correspond?

The Capitol Hill debate is primarily about money. The USPS and its employee unions are lobbying for the least painful remedy: They want the agency to be relieved of its requirement to build a health-care trust fund for its future retirees. They are supported by junk mailers, greeting card manufacturers, and magazine publishers whose businesses are, in some cases, subsidized by the post office's generously low mailing prices. Never mind that their benefactor loses money on some of their products, most notably magazines and some junk mail.

Democrats receive the vast majority of the contributions made by postal workers' unions, according to campaign finance records, so they tend to be sympathetic. President Barack Obama inserted a proposal in his 2012 budget to absolve the USPS of \$4 billion of its retiree health-care liabilities in 2011. This would enable it to slog through another year without extraordinary changes. Meanwhile, Senator Thomas Carper (D-Del.) introduced a bill on May 17 that would relieve the USPS of its prefunding headaches. "If we do nothing, we face a future without the valuable services that the postal service provides," Carper cautioned in a statement the same day. The bill would give the postal service access to as much as \$75 billion it claims to have overpaid the federal retirement system. Naturally, the USPS and its unions are pushing for this because it would swiftly erase the agency's red ink. Others in Washington dispute the postal service's claim and call this wishful thinking at a time when there is such concern about the rising deficit. They also add that the bill would do nothing to address the larger issues afflicting the USPS.

House Republicans are less charitable. They oppose anything that could be construed as a bailout. They are pushing instead for the USPS to make deep budget cuts. Even so, budget hawks sound nervous. In a March hearing, the often provocative U.S. Representative Darrell Issa (R-Calif.) said two post offices could be closed in every congressional district. He added with a laugh: "Let's hope there's not one—or three—in mine." (A spokesman for Issa says that the congressman was trying to "introduce a bit of levity" into the proceeding and is fully in favor of shuttering postal facilities.)

The irony of the political stalemate is that it may be much simpler to fix the USPS than more intractably troubled federal programs such as Medicare and Social Security. Indeed, many other countries have figured out profitable ways to run a postal service. The U.S. could learn a lot from them. Yet hardly anybody is talking about this, except for Herr.

**It's a sunny afternoon in early March, and Patrick Donahoe is talking about music.** "Are you a fan of the Allman Brothers?" he asks. "They used to sing that song *One Way Out*. There's a way out."

The 73rd Postmaster General sits comfortably in a blue leather chair in his wood-paneled Washington office, surrounded by postal artifacts. There's a portrait of original Postmaster Benjamin Franklin on loan from the Smithsonian Institution and a bronze statue of a Pony Express rider. Donahoe, a car buff, has also decorated the room with sports car stamps.

A broad-shouldered 55-year-old from Pittsburgh, he looks like he could easily deliver a heavy sack of mail. He has toted plenty in his time. He started as a clerk in his hometown mail sorting center when he was in college. "I just never left," Donahoe chuckles. "That's the story of a lot of people around here."

Donahoe, who took office in January, is surprisingly upbeat for someone in charge of an agency on the verge of bankruptcy. He says he wants to dispel "some of the negative vibes that have been floating around" the postal service. He acknowledges that first-class mail is in an inexorable decline, but he sees junk mail rebounding with the economy. In the last quarter of 2010, junk revenue climbed 7.1 percent. "That proves that there is viability in our system," Donahoe insists. (Unfortunately for the USPS, junk volume has since plateaued.)

The Postmaster General promises that if the USPS is excused from its annual health-care prepayment, he will wring enough costs out of the system to turn a profit on its remaining mail stream. He wants permission from Congress to cut weekly delivery from six to five days, which he says will save \$3 billion a year. He says he wants to reduce the USPS's headcount by 20 percent over the next five years through attrition; the agency's union contracts prohibit layoffs.

What's more, Donahoe wants to close post offices and move some of their operations into convenience stores and supermarkets, where nonunion workers can staff them. The USPS is targeting 2,000 of its 31,871 post offices. That's not much for an agency that's nearly \$15 billion in debt. Donahoe says he's doing what he can, despite a federal stricture that forbids the closing of post offices solely for economic reasons. He tells anybody who will listen on Capitol Hill that the prohibition makes little sense at a time when his agency's coffers are nearly depleted.

Some praise Donahoe for his early efforts. "I'm really high on the guy," says Anthony W. Conway, executive director of the Alliance of Non-Profit Mailers, a coalition of colleges, fraternal organizations, and advocacy groups that use the mail for fundraising. "Pat," he says, "is a breath of fresh air."

The USPS has historically placed the interests of its unions first. That hasn't changed. In March it reached a four-and-a-half-year agreement with the 250,000-member American Postal Workers Union, which represents mail clerks, drivers, mechanics, and custodians. The pact extends the no-layoff provision and provides a 3.5 percent raise for APWU members over the period of the contract, along with seven uncapped cost-of-living increases. The union is happy. "Despite the fact that the postal service is on the edge of insolvency, the union and management have reached an agreement that is a 'win-win' proposition," said APWU President Cliff Guffey on the union's website. A USPS spokeswoman said the agency agreed to the raise because it feared the decision would otherwise be made by an arbitrator who might be even more deferential to the union.

Congressional Republicans say the agreement sets a bad precedent for the USPS's other three unions, whose contracts expire this year. Fredric V. Rolando, president of the 275,000-member National Association of Letter Carriers, doesn't sound like he's interested in making major concessions. He argues the agency should be increasing rather than cutting its services. One of his ideas is to outfit postal trucks with sensors so mail carriers can thwart possible biological terrorist attacks. "They can work with Homeland Security to detect things that are in the air," Rolando says. The Homeland Security Dept. declined to comment.

**The more Phillip Herr tried to figure out** the USPS and its financial agonies last year, the more he was vexed by something: He couldn't say for sure how poorly it was doing because he had nothing to contrast it with. "There is always the 'compared to what?' question," Herr says. "Compared to FedEx? Compared to UPS?"

Herr thought it made more sense to compare the USPS to postal services in other countries. Last summer he sent a small team of analysts to Finland, Sweden, Germany, Switzerland, Austria, and Canada. He was fascinated by what they discovered.

Three decades ago, most postal services around the developed world were government-run monopolies like the USPS. In the late '80s, the European Union set out to create a single postal market. It prodded members to give up their monopolies and compete with one another. The effort roused an industry often thought to be sleepy and backward-looking.

Many countries closed as many of their brick-and-mortar post offices as possible, moving these services into gas stations and convenience stores, which then take them over—just as the USPS is trying to do now, only far more aggressively. Today, Sweden's Posten runs only 12 percent of its post offices. The rest are in the hands of third parties. Deutsche Post is now a private company and runs just 2 percent of the post offices in Germany. In contrast, the USPS operates all of its post offices.

Some of these newly energized mail services used the savings to pursue new business lines. Deutsche Post bought DHL, a package deliverer that competes with FedEx and UPS. "More than half of our workforce is outside of Germany," says Markus Reckling, executive vice-president for corporate development at Deutsche Post. "It's pretty much the same thing for our profits."

Many used their extra cash to create digital mail products that allow customers to send and receive letters from their computers. Itella, the Finnish postal service, keeps a digital archive of its users' mail for seven years and helps them pay bills online securely. Swiss Post lets customers choose if they want their mail delivered at home in hard copy or scanned and sent to their preferred Internet-connected device. Customers can also tell Swiss Post if they would rather not receive items such as junk mail.

Sweden's Posten has an app that lets customers turn digital photos on their mobile phones into postcards. It is unveiling a service that will allow cell-phone users to send letters without stamps. Posten will text them a numerical code that they can jot down on envelopes in place of a stamp for a yet-to-be-determined charge.

Anders Asberg, Posten's head of marketing and development, says the service is experimenting with these initiatives, and he expects some will prove to be lucrative. "The customers are all on these digital interfaces now," he says. "That's where the growth is going to be in the future."

Posten can afford to take chances. In 2009 the Swedish mail carrier merged with Post Danmark, the Danish postal service, creating PostNord, a company with \$6.2 billion in net sales and \$320 million in EBITDA. In 2010 the latter rose by 43 percent, to \$490 million.

"The question is, are there any special circumstances that suggest all these other countries are wrong and we are right?" says James I. Campbell Jr., a consultant in Potomac, Md., who advises foreign governments on postal policy issues. "The answer is pretty simple: The European countries are on a reasonably viable course. The U.S. is not."

Herr traveled to Sweden, Switzerland, and Finland last summer. He met with Posten executives who told him how hard they had worked to sell their plans to close post offices to a skeptical public. Not everyone approved. Some Swedes were very upset. Eventually, they got over it. In the end, they got their mail as efficiently and reliably as before.

In Switzerland, Herr met with Swiss Post executives who demonstrated the digital mail service. "You can say, 'Here's what I want,'" he explains. "'No, thank you, I'd rather not have that seed catalogue. But I would like to have my bill from Citibank ([C](#)) and my mortgage.' Well, maybe the advertising mail people wouldn't be too excited about that."

Herr returned to America full of excitement. In February he delivered a 40-page report to the House subcommittee that oversees the postal service. It makes two major points: The USPS needs to close post offices, as many foreign postal services have done despite real opposition. And the USPS needs to create products for its wired customers if it wants to play a role in the future of communication. He acknowledges some foreign digital services are in early stages, but they are in demand, and in some cases the digital technology reduces delivery costs.

Joseph Corbett, the American postal service's chief financial officer, thanked Herr for his efforts. At the same time, he said the agency was sticking to its plan. Postmaster Donahoe says he isn't so sure about the digital mail initiatives emerging outside the U.S. "The value added there might not be as much as everybody thinks," he says. Joanne Veto, a USPS spokeswoman, said in an e-mail that the USPS had hired outside consultants who examined some of these digital mail offerings and advised the agency not to pursue them: "While foreign posts did make money by diversifying their products, it took as many as 20 years before a profit was realized. In the short term, there was limited or no profit. We do not have 20 years."

Under Donahoe, the USPS is focused instead on trying to slow the migration of its customers to the Net. The man in charge of this task, which brings to mind King Canute's attempts to hold back the incoming tide, is Paul Vogel, a former letter carrier who is now the postal service's chief marketing sales officer. He is less spirited than his boss and understandably so; his job is to persuade banks to keep sending paper statements in the mail. It's a losing battle, and Vogel knows it. "Inevitably, it's going to go to those new technologies," he sighs.

Herr couldn't agree more. The other day he got a notice in the mail from the U.S. Senate Federal Credit Union. It said it was going paperless in August. Customers who still want to get their statements mailed to them would have to pay a fee. He dropped by the office on Capitol Hill to find out how much. "I have a disproportionate interest in things like this, given the work I've been doing lately," Herr says.

A credit union worker told him the fee was \$5 a month. Herr was astonished. "I thought to myself, that's \$60 a year," he recalls. "Who's going to want to do that? What happens when Bank of America ([BAC](#)) or Citigroup says you are going to have to pay to get your statement on paper? That's going to change a lot of behavior. It's going to affect the postal service. That's how they make most of their money."

**The baying begins as soon as Jim Rice** climbs out of his truck with his mail sack on his shoulder. He looks around warily. "This is the street where I've had some issues with dogs," he says.

It's a pleasant morning in early April, and Rice, a 58-year-old letter carrier, is going from house to house on Rugby Road in Cardinal Valley, a blue-collar neighborhood in Lexington, Ky. He hardly appears a threat in his white pith helmet and ill-fitting blue uniform. The pets on his route have a different view. Rice has fought off Piper, a black Labrador retriever. He recently used his mail pouch to fend off Rocky, a German shepherd.

The Kentucky letter carrier is stoic about his scrapes. Some things about his job are eternal. Others are changing rapidly. He carries a lot more of what he calls "standard mail." "Civilians call it junk mail," Rice says, joking. "We don't like that term. We call it job security."

Rice's ritual hand delivery of the mail remains the essence of the USPS's business. Until fairly recently, this was a fabulous model, although its history of success, in retrospect, is notable for its missed opportunities.

As America's population expanded, so did the postal service. In its early years, people paid to receive mail. In 1863 the U.S. Post Office Dept., a Cabinet level agency, was flush enough to begin offering free city delivery. In 1896 it expanded free service to rural areas, providing what it now refers to as "universal service" to all Americans. Mail volume exploded. In cities such as Philadelphia and Boston, letter carriers made their appointed rounds three times a day.

Inevitably, perhaps, there were problems. The post office became a patronage dumping ground. After decades of mismanagement and neglect, service broke down completely in Chicago in 1966. "The sorting floors were bursting with more than 5 million letters, parcels, circulars, and magazines that could not be processed," Lawrence O'Brien, the Postmaster General at the time, would recall somewhat poetically. "Outbound mail sacks formed still gray mountain ranges as they waited to be shipped out."

Four years later, President Richard M. Nixon signed the Postal Reorganization Act, transforming the Post Office Dept. into the U.S. Postal Service, a government corporation that was supposed to pay for itself and behave more like a private business. This proved a naive assumption. The USPS's leaders rewarded their union employees with more expensive benefits than most federal employees enjoy. According to the U.S. Postal Service Inspector General's Office, it covers 79 percent of most of its employees' health benefits, compared with the typical 72 percent for federal workers.

The USPS was slow to react to shifts in the industry. In the late '70s, Congress prodded it to allow private companies to carry letters needing urgent delivery. FedEx and UPS built enormously valuable businesses on the USPS's turf. They weren't required to visit every doorstep in the country on a daily basis. They set their own rates and had no qualms about extracting concessions from their unions. The postal service tried to compete,

without much success. "They just cleaned the postal service's clock," says Tad DeHaven, a budget analyst at the Cato Institute, a libertarian think tank in Washington. It didn't matter at the time. The agency had its slower-moving letter monopoly, and mail volume kept climbing.

The USPS slumbered as the postal service industry was upended overseas. Michael Coughlin, former Deputy Postmaster General, attended meetings in Brussels in the early 1990s where his peers in Sweden and Germany described the innovative things they were doing. "I would sit there and think, I wish that was us," he says. Coughlin left the USPS in 1999 to work at Accenture ([ACN](#)), a global consulting firm, where he advised foreign postal services on their streamlining efforts. He retired in 2009.

In the late '90s, there was talk within the USPS about reforms, including privatizing the organization. Robert Reisner, a former USPS vice-president of strategic planning, recalls raising some of these issues during a visit to the White House with a Clinton Administration official: "She said, 'Well, we would have to ask our union friends. You know they are critical to the coming campaign.' "

At the same time, e-mail took hold. By 2000 the USPS was losing money. The GAO warned that the service might not be able to cover its retiree health-care costs.

Congress came up with what it thought would be a fix. In 2006 it relieved the postal service of \$27 billion in pension liabilities for workers with military service. At the same time, the USPS agreed to make annual payments of \$5.5 billion for the next 10 years to build up a fund for future retirees. John E. Potter, the Postmaster General at the time, was ecstatic when the bill was signed into law. "We're planning for the future right now," he said. "Today the postal service is operating in the black."

The USPS was O.K. that year. Then, over the next three years, the economy collapsed, and the service lost \$12 billion.

A former letter carrier in the Bronx, Potter remained ebullient. He testified before Congress in 2009 that mail volume would eventually return. Herr sat nearby. He says he was stunned. Potter announced his resignation six months after Herr issued his report on the USPS's broken business model. The postal service rushed out a study of its own around the same time by McKinsey that reached the same dispiriting conclusions.

The USPS, however, still seems to be in denial. "The postal service is already carrying more junk than first class," says postal consultant Campbell. "Pretty soon it's going to be a government-run advertising mail delivery service. Does that make any sense? It doesn't make any sense."

There are still flaws in the USPS's junk-centric plan. The service now predicts that total mail volume will decline from 171 billion pieces annually in 2010 to 150 billion in 2020. That's a best-case scenario. The worst-case, according to its own projections, is 118 billion.

That's still a lot of stamps to sell. The problem is that costs keep rising. The number of addresses the USPS services climbs at an average of roughly 1 million a year as the population grows. Meanwhile, the agency continues to raise the salaries and benefits of its clerks and mail carriers even with periodic freezes.

"I really believe that the USPS is going to get to a point where, regardless of what it does with the prefunding [of retiree health care], it is going to implode," says R. Richard Geddes, an associate professor of policy analysis and management at Cornell University. "It is either going to default on those obligations to its retirees or we are going to have to give it a direct bailout from the United States taxpayers."



The implosion could happen this year because of the stalemate in D.C. Maybe that's what it will take for Americans to get a modern mail service. Even Donahoe, who advocates something less, sounds as if he would welcome it because there's no other way out. "Some people say if you crash the system," he says, "then people will pay attention to you."

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