Appendix F

APPENDIX F — Fixed Versus Variable Costs

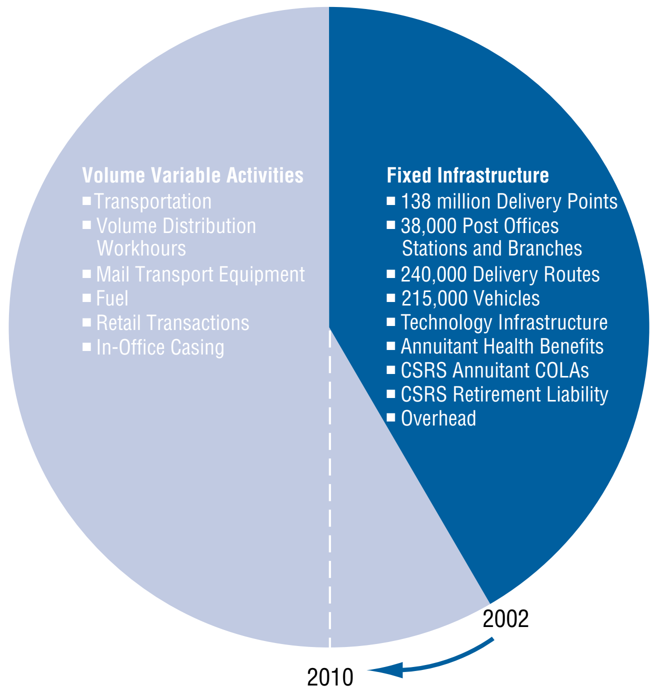
The universal service obligation requires a significant infrastructure investment. Almost one-half of total postal costs are spent on fixed costs. Examples include most of the cost related to more than 38,000 post offices, stations and branches; 240,000 delivery routes to service over 137 million delivery addresses; 215,000 vehicles and significant annuitant retirement costs. Technology infrastructure and other overhead costs are also mostly fixed.

The "every day" portion of the universal service obligation contributes significantly to these fixed costs. A significant portion of postal costs is spent on fixed resources and does not increase or decrease when volume changes. Letter carriers travel their complete routes, making over 500 million new delivery stops annually; trucks transport mail between facilities each day to meet service commitments, and retail facilities are open each business day no matter what level of activity occurs. Nearly one-half of all postal costs are fixed and their proportion of total cost will continue to increase. Of these fixed costs, $10 billion is directly related to the Postal Service's delivery obligation.

As indicated in Appendix D, the Postal Service faces significant future costs due to payment of deferred retirement costs, CSRS annuitant COLAs and annuitant health benefits. The Civil Service Retirement System costs for retired or soon to be retired employees, will have to be paid, regardless of future volume growth or volume decline. Because much of this cost is fixed and growing, it will continue to be a significant cost.

The increasing proportion of fixed costs also exposes the Postal Service to the danger of rising unit prices. Postal prices must cover both fixed and variable costs. If volume remains constant or declines, a rising pool of fixed costs will have to be covered by a constant or lower volume base. In addition, as discussed in Appendix E, there is a real danger of possible volume declines. This would lead to more fixed costs per piece and higher overall unit prices.

FIXED VS. VARIABLE COSTS



TOTAL FIXED COSTS