

## **Public Policy and Funding the News**

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# POSTAL SUBSIDIES

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## 1. Introduction

Postal subsidies have historically been an important way in which the government has supported the news industry<sup>i</sup>. Publishers of newspapers, journals and magazines have benefited from subsidized postage rates since the inception of the postal system. In the recent past however, postal subsidies have been reduced dramatically in real and absolute terms. Nowadays, certain classes of mail that the news industry makes use of actually receive negative subsidies, or “taxes”. Given the huge amounts that the news industry spends on postage every year, it is likely that postal subsidies would be extremely relevant to the future viability of the news industry.

Here are some quick facts on past and present levels of support that the news industry has received from the postal system:

### 1. Subsidies on Periodical Mail

- a. The Newspaper Association of American (NNAA)<sup>ii</sup> (2009) reports that publishers of daily newspapers spent approximately \$107 million on **periodical mail** postage in 2006, worth around \$113 million in 2009 dollars<sup>iii</sup>.
- b. The U.S. Postal Service (USPS)<sup>iv</sup> (2006) reports that the total subsidy<sup>v</sup> to all patrons (including but not limited to newspapers, journals and magazines) of periodical mail was approximately \$273 million in 2006, worth about \$288 million in 2009 dollars<sup>vi</sup>. Of this, the share of daily newspapers<sup>vii</sup> was approximately \$13 million, worth about \$14 million in 2009 dollars.
- c. According to Kosar<sup>viii</sup> (2009), the total subsidy to all patrons of periodical mail in 1967 was approximately \$400 million, worth about \$1,969 billion in 2009 dollars. Therefore, there was a dramatic reduction in the quantum of periodical mail subsidies to all patrons over the last 40 years.
- d. Periodical mail subsidies to all patrons amounted to about 75 percent of the total cost of delivery in 1967 (Kosar, 2009). In 2006, this figure reduced to around 11 percent of the cost of delivery<sup>ix</sup>. This was a dramatic reduction in the quantum of periodical mail subsidies to all patrons as a proportion of delivery costs, from 75 percent to 11 percent over the last 40 years.

## 2. Subsidies on Standard Mail

- a. NAA (2009) reports that publishers of daily newspapers spent approximately \$786 million on **standard mail** postage in 2006, worth around \$830 million in 2009 dollars.
- b. USPS (2006) reports that the total tax<sup>x</sup> on all patrons (including but not limited to newspapers, journals and magazines) of standard mail was approximately \$7.134 billion in 2006, worth about \$7.542 billion in 2009 dollars. Of this, the share of daily newspapers<sup>xi</sup> was approximately \$282 million in 2006, worth about \$298 million in 2009 dollars.
- c. The U.S. Government Printing Office (USGPO)<sup>xii</sup> (1970) reports that patrons (including newspapers among others) of the standard mail service (or third-class mail as it was known then) in 1971 were expected to receive on average postage subsidies at the rate of about 37.55 percent on the costs of delivery. USPS (2006) reports that this subsidy became a “tax” of around 55.99 percent of the costs of delivery in 2006. This represents a dramatic reduction, and even reversal in the quantum of standard mail subsidies as a proportion of delivery costs.

In summary, publishers of newspapers, journals and magazines have always received and continue to receive subsidies from the postal system for periodical mail, while they were formerly subsidized but are now taxed by the postal system for standard mail. The quantum of subsidies on both periodical mail and standard mail has declined dramatically in real as well as percentage terms over the last 40 years.

Since daily newspapers in 2006 spent around 7 times more on standard mail postage than they did on periodical mail, they were taxed on net by the postal system, to the tune of approximately \$269 million, worth around \$284 million in 2009 dollars. In fact, the quantum of tax paid by daily newspapers to the postal system exceeded the quantum of subsidies received by daily newspapers from the postal system by around 22 times in 2006.

## 2 History and future of subsidies on rates of postage for periodical mail<sup>xiii</sup>

Publishers of journals and magazines, as well as those national newspapers that mail their products to customers all around the country, use the periodical mail service of the postal system in order to deliver their products. Periodicals have received postal subsidies since the postal system was first instituted. Initially, postage on all categories of mail was paid by the addressee, not the sender. According to the Post Office Act of 1792, postage charged to the recipients of magazines was lower than that charged to the

recipients of letters, while that charged to the recipients of newspapers was lower still (Kosar, 2009). Although the system changed in 1874 to the more conventional “sender pays” system, the rates charged to periodicals still provided a substantial subsidy to senders.

Since 1879, the definition of a periodical has been more or less constant. In order to be treated as a periodical, a publication had to be devoted primarily to “information of a public character or devoted to literature, the sciences, arts, or some special industry” (Kosar 2009, pg.4).

Kosar (2009, pg.5) reports that in 1960, the definition of a periodical was amended to include only those publications which:

- (1) *were regularly issued at stated intervals as frequently as four times a year and bears a date of issue and is numbered consecutively;*
- (2) *issued from a known office of publication;*
- (3) *formed of printed sheets;*
- (4) *published for the dissemination of information of a public character, or devoted to literature, the sciences, arts, or a special industry; and*
- (5) *had a legitimate list of subscribers.*

Further, “any publication seeking the periodicals postage rate could not consist of more than 75 percent advertising in more than half of any of its issues in any 12-month period” (Kosar 2009, pg.5). Thus, a clear distinction was made between periodicals that had had a public information role to play and periodicals that were more concerned with advertising – only the former being eligible for subsidized rates.

Kosar (2009) reports that periodicals postage subsidies in 1967 contributed \$400 million to the Postal System’s budget deficit of \$1.2 billion. The Postal System estimated that postage on periodicals in 1967 covered only about one-fourth of their delivery costs (i.e. that the postal system provided a 75 percent subsidy on periodicals postage). In 1971, the situation was equally grim, with total second- class mail (what is today known as periodicals mail) generating \$157.7 million in revenues but costing \$843.2 million to deliver, thus causing a loss of approximately \$685.5 million to the postal system (USGPO, 1970).

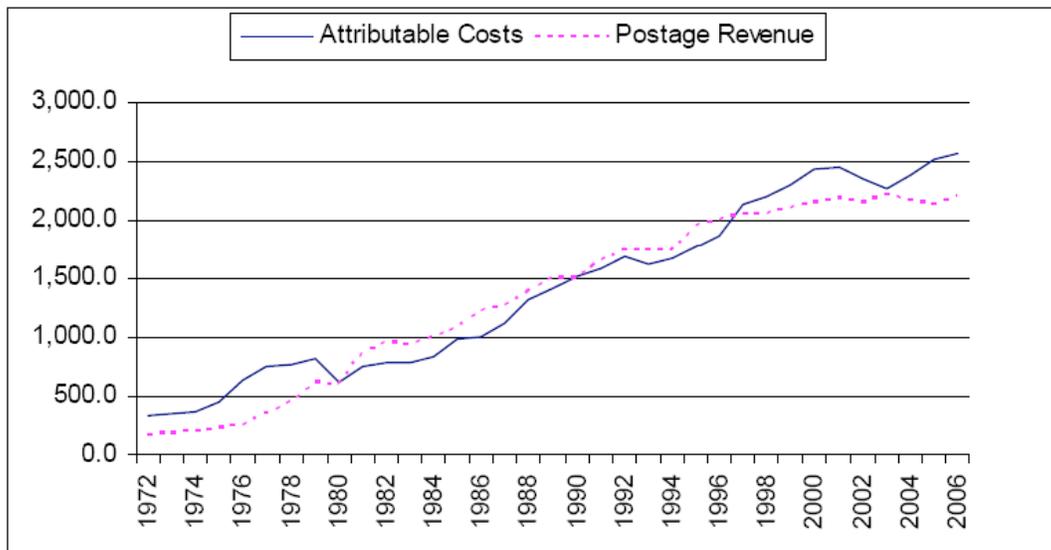
Recognizing the financial crisis in the postal system, in 1970, the Postal Reorganization Act (PRA) abolished the Post Office Department and created USPS, “an independent establishment of the executive branch”, which was supposed to be financially independent (Kosar 2009, pg.6). Postal rates were no longer set by Congress but by a Postal Regulatory Commission. For the first time, PRA required periodicals (and all other mail classes) to “bear the direct and indirect postal costs attributable to that class or type (attributable costs) plus that portion of all other costs (institutional costs) of the Postal

Service reasonably assignable to such class or type” (Kosar 2009, pg.8).

Thus, it was no longer necessary to provide a subsidy to periodicals aside from the requirement for lower rates for the editorial part of a periodical than for the advertising part. This rule, however, required the USPS to allocate costs of delivery of mail for all classes into two heads: attributable costs, and institutional costs and make an attempt to recover the attributable costs of all mail classes including periodical from customers. Consequently, the periodicals postage rate increased 2.17 times from 1971 to 1976 (Kosar, 2009). Despite this, the postal system continued to offer subsidies to periodicals, albeit at reduced levels. In 1976 Congress amended PRA to make PRC consider “the educational, cultural, scientific, and informational value to the recipient of mail matter” when setting postal rates, thus setting the stage for continued subsidy of periodicals, but without setting an explicit rate of subsidization (Kosar 2009, pg.9).

Figure 1 below depicts the history of periodical mail revenues and attributable costs. Where the postage revenue exceeds the attributable costs, then the excess is the amount available to meet the institutional costs of delivery for that class of mail. Since there is no information available about the institutional costs of delivery, it is not possible to determine the total amount of subsidy to periodicals. However, when postage revenue dips below attributable costs, then the amount of shortfall represents the lower bound on the amount of subsidy to periodicals, since institutional costs are always positive.

**Figure 1. Periodicals Attributable Costs and Revenues, FY1972-FY1976 (millions of dollars)**



Reproduced from Kosar (2009)

Note from Figure 1 that during the period 1980 to 1996, postage on periodicals more than covered their attributable delivery costs – thus it is not possible to determine how much if any subsidy there was to periodicals. However, from 1996 onwards, postal revenue dipped below attributable costs – thus the postal system once more subsidized the delivery of periodicals. By 2006, the total subsidy on periodicals was \$273 million, or about \$288 million in 2009 dollars. Nevertheless, the quantum of subsidy was far less in proportional terms over the entire period 1996 – 2006 than it was in 1967.

Recall that these figures for periodicals subsidies include subsidies for newspapers, journals as well as magazines. Although direct figures are not available, it is possible to estimate the subsidy figure for daily newspapers using back-of-the-envelope calculations. In 2006, the subsidy per dollar of periodicals postage revenue was 12.34 cents (USPS, 2006). Assuming that this ratio applied to all patrons of periodical mail in 2006, the NAA (2009) estimate of daily newspaper expenditures of \$107 million on periodicals postage in 2006 would mean a subsidy to daily newspapers of around \$13 million, worth around \$14 million in 2009 dollars. Once again, it is important to stress that this number is a “guesstimate”.

The diminishing trend in the quantum of subsidies to periodical mail over the period 1967-2006 (highlighted in the quick facts subsection of the introduction) has continued into 2009. Post 2006, Kosar (2009) reported that periodical postage rates were raised 11.8% in light of USPS complaints that periodicals as a whole contributed an insignificant portion of the overhead costs of the USPS, and that some periodicals did not even pay their attributable costs.

The new rate schedule considered by PRC, however, reduced postage costs for mailers who undertook mail preparation activities that reduced the postal system’s cost of delivery. This was a preliminary step by the USPS to recognize the existence of implicit subsidies offered in the mechanisms used to deliver different mail classes (a point to which we return in a later subsection), part of which was the failure to insist on mail preparation activities prior to mail being handed over to the postal system for delivery. This move drew criticism from publishers of small periodicals that could not afford mail preparation activities. The rate increase itself drew criticism across the board from publishers who claimed that these large increases “would threaten the free flow of information and free speech” by endangering periodicals as a class of publications (Kosar 2009, pg.13).

The NAA<sup>xiv</sup> reported that in 2007, the PRC used powers granted under the 2006 Postal Accountability and Enhancement Act to adjust postal rates on an

annual basis for all classes of mail (including periodicals) as long as rate changes for a particular class of mail stayed below a price cap pegged to the consumer price index. According to the NAA, this new system would likely result in smaller, but more frequent, rate adjustments for mailers, and could hence lead to less predictability in postal rate changes. Further, they concluded that these powers could be used by the postal system to continue to progressively eliminate all subsidies on periodical postage.

The NAA<sup>xv</sup> also reported that in May 2009, the postal system enforced the second rate change under the new post 2006 “price cap” system. The applicable rate of inflation below which price increases had to lie was 3.8 percent. Exploiting its rate-setting power to the maximum extent, the postal system increased rates on the entire standard mail class by 3.781 percent, and those for the periodical mail class by 3.966 percent.

### **3 History and future of subsidies on rates of postage for standard mail**

Newspapers make intensive use of the **standard mail** service of the postal system to deliver (1) total market coverage (TMC) products such as advertising inserts to non-subscribers; (2) solo direct mail offerings; and (3) mail solicitations. The NAA estimated that in 2006, 71 percent of all daily newspapers sent out a TMC product once a week, while 15 percent sent out a TMC product twice a week. Further, newspapers were the number 1 standard mailers in 63 percent of the market, and were the number 2 standard mailers in 24 percent of the market (NAA, 2009).

In 1970, what is today known as standard mail was known as third-class mail. USGPO (1970) reported that total third class mail revenues in 1971 were \$876 million, but total costs of delivery were \$1.403 million, thus conferring a subsidy of \$527 million on patrons. This amounted to a subsidy rate of around 60.13 percent on postage revenues, or a subsidy rate of around 37.55 percent on delivery costs. The value of this subsidy in 2009 dollars was \$2.164 billion. Note that this subsidy was shared among all patrons of the third-class mail service, not just newspapers. Unfortunately, it is impossible to calculate what percentage of this subsidy went to newspapers, but it is safe to say that newspapers enjoyed a significant subsidy in proportional terms on their patronage of the third-class mail service.

In 2006, the category formerly known as third-class mail was known as standard mail. USPS (2006) reported that total revenue from standard mail was \$19.877 billion, but costs of delivery were \$12.743 billion, yielding a “tax” by the postal system on standard mail patrons of around \$7.134 billion. This amounted to a “tax” rate of around 35.89 percent on postage revenues, or a

“tax” rate of 55.99 percent on delivery costs. The value of this “tax” in 2009 dollars was \$7.542 billion.

Note that this “tax” was imposed on all patrons of the third-class mail service, not just newspapers. Although we do not have direct figures, we can back out the quantum of “tax” imposed on newspapers from the expenditure of newspapers on standard mail in 2006. Assuming that the average “tax” rate is the same across all patrons of standard mail, we can calculate that the NAA-reported figure of \$786 million expenditure by newspapers on standard mail in 2006 amounted to a “tax” of \$282 million on newspapers (at the tax rate of around 35.89 percent on postage revenues). The value of this tax in 2009 dollars is \$298 million.

We can therefore conclude that all patrons (including but not limited to newspapers) of what is today known as the standard mail service have experienced dramatic reductions (and even reversals) in the level and rate of subsidies from the postal system over the period 1967 to 2006. Subsidies of 60.13 percent on postage revenues in 1967 became a “tax” of 35.89 percent on postage revenues in 2006. Newspapers alone in 2006 bore a “tax” of \$282 million, where they had been experiencing a subsidy (of unknown amount) in 1967. When compared to the tiny subsidy newspapers have been receiving from the postal system on periodicals postage, the “tax” imposed on newspapers on account of standard mail postage is around 22 times bigger than the subsidy offered them on account of periodicals postage. Needless to say, newspapers on the whole are subsidizing, rather than receiving subsidies from the postal system.

This trend of reverse subsidization at the cost of newspapers (and indeed all other patrons of standard mail) is expected to become stronger in future. In May 2009, the postal system increased rates on the entire standard mail class by 3.781 percent. Within the class of standard mail, the rate increases were more severe for high-density mail (mail numbering at least 125 pieces on a postal carrier’s route) than for saturation mail (mail addressed to at least 90 percent of all residential addresses, or at least 75 percent of all business and residential addresses on a postal carrier’s route).

Newspaper’s TMC products such as advertising inserts are delivered to subscribers by being inserted into the newspaper, and to non-subscribers through the standard mail system. Depending on the extent of the market not covered by the newspaper’s subscriber base, newspapers either use the high- density standard mail route, or the saturation standard mail route to deliver advertising inserts to non-subscribers. Consequently, newspapers are sensitive to any rate increases in either category of standard mail.

Given that 64 percent of newspapers' TMC products were high-density mail in 2006, while 36 percent were saturation mail, any rate change is expected to have a large effect on postage costs (NAA, 2009). According to the NAA, the most recent May 2009 rate increase saw a 5.7 percent increase in rates for high-density mail entered into the postal system through local post offices, and a 5.4% increase in rates for saturation mail entered into central postal facilities. For saturation mail, the rate increases were 1.4% for mail entered into local post offices, and 1.3% for mail entered into central postal facilities. In fact, the next section shows that not only have rates been increasing, but that way in which newspapers get their standard mail products over to the postal system has also changed, to the apparent detriment of newspapers.

#### **4 Implicit subsidies on delivery mechanisms**

The main change instituted by the postal system in its delivery mechanism was the introduction of the flats sequencing system (FSS) in 2008. FSS is an automated sorting system for flat pieces of mail in both periodical and standard mail categories, and arranges mail by delivery date as well as in the order that the mail carrier has to deliver them. This system was aimed at reducing the amount of time carriers spent sorting mail prior to delivery, and is envisaged to save the postal system up to \$600 million a year (NAA<sup>xvi</sup>, 2009).

As part of this new system, high-density mail (which accounts for 64 percent of newspapers' TMC products) can no longer be entered into the local post office, but has to be entered into central postal facilities for sorting. Saturation mail (which accounts for 36 percent of newspapers' TMC products) on the other hand can continue to be entered into local post offices. Jones<sup>xvii</sup> (2008) notes that the main competitors of newspapers in the TMC market are saturation mailers such as Valassis Communications Inc., and Harte-Hanks Inc., which can continue to enter their product at the local post office. Thus, the introduction of the FSS system has removed a principal implicit subsidy to the newspaper industry – the freedom to directly enter mail into local post offices instead of at an upstream location for pre-delivery sorting.

Jones (2008) reports that the NAA identifies two major concerns arising out of the new system. The first concern is that newspapers will have to put in place two separate distributional channels (central postal facilities for high density products and local post offices for saturation products) for the same TMC product depending on the mailing intensity of the product. These will likely increase newspapers' production and transportation costs, by up to 3 percent. Jones (2008) also notes that newspapers would be put at a

competitive disadvantage against saturation mailers since they would lose the discounts they currently receive when delivering products to the local post office as opposed to the central postal facility.

The second concern of the NAA is that taking high-density TMC products to central postal facilities may jeopardize newspapers' ability to ensure timely delivery of newspapers as well as non-subscriber products. As Jones (2008) elaborates, newspapers would now have to deliver high density products to central postal facilities 2-3 days before the delivery date, while saturation products need be delivered at the local post office only 1-2 days ahead of the delivery date. Furthermore, newspaper officials have expressed concern as to (1) whether high-density inserts in packages would fall out during processing or even jam the sorting machines, thus leading to incomplete delivery of TMC products to customers, and (2) whether the USPS can actually deliver the high-density inserts by the date newspapers have promised to their advertisers.

The full effect of these new rate changes as well as delivery systems on the newspaper and magazine subsector of the news industry is as yet unclear. What is clear is that they constitute a significant reduction in both the explicit and implicit subsidies the postal system offers the news industry.

## **5. Conclusion**

Although postal subsidies have historically been an important way in which the government has supported the news industry, the quantum of postal subsidies has declined drastically over the past 40 years, and has even mutated today into a tax on certain classes of mail used by the news industry. Given the huge amounts that the news industry spends on postage every year (daily newspapers alone spent \$973 million in 2006); it is likely that postal subsidies would be extremely relevant to the future viability of the news industry.

The main source of revenue for the newspaper industry is advertisements, and newspapers make heavy use of the standard mail service of the postal system to deliver their advertising products to customers. Since the postal system is lurching from loss to ever-increasing loss year after year, it is likely that subsidies on periodical mail will continue to reduce while taxes on standard mail will continue to increase, thus worsening the situation of newspapers. A return to the munificent subsidy levels of the 1970s, while offering comfort to the news industry, will likely bankrupt the postal system, a contingency that the postal reforms of 1970 were instituted to prevent.

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- <sup>i</sup> By news industry, we refer to newspapers, journals and magazines.
- <sup>ii</sup> NAA, “Daily Newspapers and the Mail”, Newspaper Association of America presentation to the Mailers’ Technical Advisory Committee of the USPS, undated, <http://ribbs.usps.gov/files/mtac/MTAC0508/MTAC.April.2008.ppt#307,1>, Slide 1, Accessed 11 August 2009
- <sup>iii</sup> Unless otherwise mentioned, all dollar figures are in current dollars
- <sup>iv</sup> USPS, “Cost and Revenue Analysis: Fiscal Year 2006”, [http://www.usps.com/financials/\\_pdf/fy06cra.pdf](http://www.usps.com/financials/_pdf/fy06cra.pdf), Accessed 11 August 2009.
- <sup>v</sup> A subsidy in this case means that the revenues of the postal system from this category of service were less than the costs to the postal system for provision of this category of service.
- <sup>vi</sup> 2009 dollar figures are adjusted for inflation using NASA’s GDP deflator inflation calculator available at <http://cost.jsc.nasa.gov/inflateGDP.html>
- <sup>vii</sup> Author’s own calculations (details available upon request).
- <sup>viii</sup> Kevin R Kosar, “Postage Subsidies for Periodicals: History and Recent Developments”, Congressional Research Service Report R40162, [http://www.postalmuseum.si.edu/industrywhitepapers/CRS-Postage\\_Subsidies\\_for\\_Periodicals.pdf](http://www.postalmuseum.si.edu/industrywhitepapers/CRS-Postage_Subsidies_for_Periodicals.pdf), Accessed 11 August 2009
- <sup>ix</sup> Author’s own calculations (details available upon request).
- <sup>x</sup> A tax in this case means that the revenues of the postal system from this category of service exceeded the costs to the postal system for provision of this category of service.
- <sup>xi</sup> Author’s own calculations (details available upon request).
- <sup>xii</sup> USGPO, “Hearings before the Subcommittee on Postal Rates of the Committee on Post Office and Civil Service”, US Government Printing Office, Serial No. 91-24, 1970
- <sup>xiii</sup> This sub section draws heavily on Kosar (2009)
- <sup>xiv</sup> Newspaper Association of America (NAA), “PRC Issues New Postal Rate Setting Rules”, <http://www.naa.org/Public-Policy/Circulation-Issues.aspx?tab={F3ECB443-05BF-4DF>, Accessed on 11 June 2009.
- <sup>xv</sup> Newspaper Association of America (NAA), “USPS Announces New Postal Rates and Incentive

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Program for Saturation Mail”, <http://www.naa.org/Public-Policy/Postal-Affairs.aspx>, Accessed on 11 June 2009

<sup>xvi</sup> Newspaper Association of America (NAA), “The Flats Sequencing System (FSS)”, <http://www.naa.org/Public-Policy/Postal-Affairs.aspx>, Accessed 11 June 2009

<sup>xvii</sup> Mary Lynn F Jones, “NAA Seeks Exemption from New Mail Distribution System”, *Public Policy Magazine*, April 2008, <http://www.naa.org/docs/Public-Policy/Presstime-FSS-Article.pdf>, Accessed 11 August 2009