United States General Accounting Office

GAO

Report to the Ranking Minority Member, Subcommittee on Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate

September 1996

POSTAL SERVICE REFORM

Issues Relevant To Changing Restrictions on Private Letter Delivery

GAO/GGD-96-129A Volume I

GAO

United States
General Accounting Office
Washington, D.C. 20548

General Government Division

B-260012

September 12, 1996

The Honorable David Pryor
Ranking Minority Member
Subcommittee on Post Office and Civil Service
Committee on Governmental Affairs
United States Senate

As you requested, this report discusses the statutory restrictions on the private delivery of letters. You were concerned about how possible changes to those restrictions and their enforcement by the Postal Service might affect its ability to meet public service obligations. These obligations, which are spelled out in the Postal Reorganization Act of 1970, include universal access to postal services and a uniform rate for at least one class of mail.

Mail service has long been a basic part of American culture and business. It is also generally considered to be an inherently governmental function. The Constitution empowers only Congress to establish post offices, and it is a federal criminal offense for anyone other than the government to deliver most letters.

Some large mailers and private carriers want Congress and the Postal Service to allow greater competition for letter mail delivery. However, some Members of Congress, Postal Service officials, and others in the mailing community are concerned about how increased private delivery might affect the Postal Service's ability to sustain mail services traditionally provided by government, especially since the Service now receives almost no federally appropriated money.

Responding to that concern, our objectives were to (1) determine the historical and current basis for restricting private delivery of letters, including the Service's efforts to administer and enforce those restrictions; (2) document changes in private sector letter delivery capacity since 1970; (3) analyze the possible financial effects on the Service's revenues, costs, and postage rates if restrictions on private delivery of letters were to be changed; and (4) obtain information on how some recently reformed foreign postal administrations provide universal service and restrict private letter delivery. We also identified issues that may be relevant to legislative deliberations. For the purpose of our review, we assumed that the longstanding national policy of providing universal service to all communities and, for certain letters, a uniform postage rate will remain in effect.

The results of our review are summarized in volume I of this report. Our detailed findings are presented in volume II.

Background

For over 200 years, the Postal Service and its predecessor have operated with a statutorily imposed monopoly restricting the private delivery of letters. The monopoly was created by Congress as a revenue protection measure to enable the postal system to fulfill its mandate of providing uniform rates for at least one class of letter mail and delivery of letter mail to patrons in all areas, however remote.

The monopoly was established in a set of criminal and civil laws called the Private Express Statutes (the Statutes) (18 U.S.C. 1693-1699 and 39 U.S.C. 601-606). A related law prohibits persons from placing letters without postage into a mailbox (18 U.S.C. 1725). Violators of these restrictions are subject to maximum fines of $5,000 for individuals and $10,000 for organizations and, in some cases, imprisonment.

For purposes of the Statutes, the definition of a letter is established by the Postal Service in regulation. The Postal Service broadly defined a letter as any message directed to a specific person or address and recorded in or on a tangible object. (See 39 C.F.R. 310.1.)

Although Congress has reviewed the need for the monopoly and has broadened or reduced it at various times over the past 200 years to accommodate changes in technology and transportation, the statutory monopoly has generally remained intact. The Postal Reorganization Act of 1970 did not change it, but Congress directed the newly established Postal Service Board of Governors to evaluate the need to modernize the Statutes. In a 1973 report, the Board recommended no change, stating its belief that the Statutes were still needed as a revenue protection measure to prevent "cream-skimming," i.e., competitors offering service on low-cost routes at low prices, leaving the Service with high-cost routes.

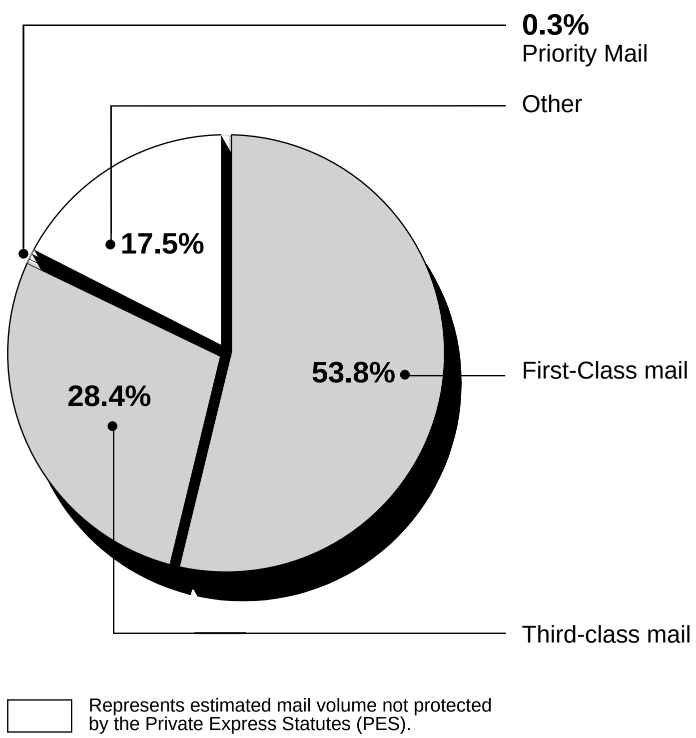
Since the 1970 reorganization, however, the Service has narrowed the scope of the monopoly by exempting certain types of correspondence from the definition of a letter in its regulations and by suspending the Statutes for other letters.

Under the Postal Reorganization Act of 1970 (the 1970 Act), Congress expected the Service to operate in a businesslike manner while, at the same time, fulfilling its mission as a public service. To this end, Congress removed the Service from its position in the Cabinet and made it an "independent establishment of the executive branch." It exempted the Service from many of the laws that apply to federal agencies and gave the Board of Governors the sole power to appoint and fire the Postmaster General and the Deputy Postmaster General. However, the Service is not a business entity. It is subject to congressional oversight and to certain laws that apply to other parts of the executive branch. It is also required to submit proposed changes in postal rates and fees and in postal classifications and products to the independent Postal Rate Commission. Proposed changes are subject to a review process, which includes public hearings where interested parties, including the Service's competitors, can voice their views.

In 1995, about 90 percent of all U.S. mail originated with business or institutional mailers and the remaining 10 percent with households. Letters fall almost entirely into two classes: First-Class (including Priority Mail) and third-class, which consists largely of advertisements.[1] The Service has defined a letter broadly but has not determined precisely how much of the mail stream is subject to the Statutes. However, reasonable estimates of the protected mail can be made on the basis of the Service's detailed breakouts of the mail stream the Service used in setting postage rates. The Commission used these breakouts to estimate that the vast majority (83 percent) of the Service's overall mail volume meets the Service's definition of a letter and thus is subject to the Statutes. (See fig. 1.)

[1]We have used the Postal Service's preferred capitalization for First-Class, Express, and Priority Mail, which are registered trademarks. In a recently approved mail reclassification, third-class mail was redesignated as standard mail, which also incorporates parcels and other mail pieces formerly designated as fourth-class mail. The terms and contents for First-Class and Priority Mail were not changed.

Figure 1: Estimated Postal Service Domestic Mail Volumes Subject to the Private Express Statutes, Fiscal Year 1995 (Millions of Pieces)



Note 1: Total mail pieces in fiscal year 1995 were about 180.7 billion, about 464,000 pieces of which do not fall into the categories shown and are excluded from this figure.

Source: Postal Rate Commission estimates based on Postal Service data.

In June 1996, the Chairman of the Subcommittee on the Postal Service, House Committee on Government Reform and Oversight, introduced legislation (H.R. 3717) to reform the Postal Service. Under this bill, among other provisions, a new system for establishing postage rates, classes, and services would be established, and delivery of letter mail priced at less than $2.00 would be restricted to the Postal Service. According to the Subcommittee's analysis, if the bill is enacted into law, more than 80 percent of the Service's total revenue would still be protected by law and therefore the Service would still be provided sufficient revenue to carry out its mandates to the American public.

Results in Brief

The Private Express Statutes, which protect 82 percent of the Postal Service's revenue from competition, have been justified by Congress and the Service on the basis of both public policy and economic considerations. Specifically, it has long been the federal government's policy that mail service will be provided to all communities and that certain mail will bear a uniform rate. The Service believes that the Statutes in their present form are necessary to protect its mail volume and revenue base, thus enabling it to carry out that policy while also operating within various legal and regulatory constraints. From an economic perspective, the theory underlying the Statutes is that a single supplier, i.e., the Postal Service at present, can provide mail services at the lowest total cost to the public.

Although the purpose of the Statutes is to help ensure that the Service has adequate revenue, enforcement and administration of the Statutes have become increasingly problematic. Because of complaints and pressures from mailers, competitors, and Congress, the Service has not initiated any audits to determine mailer compliance with the Statutes since 1994. The Service now relies largely on mailers and private delivery firms to voluntarily comply with the Statutes. Because of these same pressures, the Service has issued regulations suspending the Statutes in order to allow private firms to deliver any letter considered to be extremely urgent, as well as all letters bound for other countries. Some parties have questioned whether Congress intended that the Service should allow more private delivery of letters by suspending the Statutes. Moreover, various parties have questioned the validity and appropriateness of the underlying economic theory that a single organization can provide mail service to the public more efficiently and economically than multiple organizations. These questions remain unanswered and continue to be debated.

Since 1979, after the Service suspended the Statutes to allow overnight express delivery of extremely urgent letters by private carriers, private letter delivery capacity has increased significantly. We estimated that the Service's five principal competitors (Airborne Express, DHL Airways, Federal Express, Roadway Package System, and United Parcel Service) account for more than 85 percent of all U.S. domestic expedited letter and parcel delivery revenues.

Four of the competitors told us that they could deliver additional letters, particularly those currently designated by the Service as Priority Mail (2- to 3-day delivery time), if given the opportunity. Priority Mail consists of both letters, which are protected under the Statutes, and packages, which are not. Postal Service officials believe that a significant portion and possibly up to 70 percent of the Priority Mail volumes is letters. Although Priority Mail accounted for less than 1 percent of the Service's mail volume in fiscal year 1995, it represented 5.8 percent (about $3.1 billion) of its total revenue.

Other private companies known as "alternate delivery" firms have developed a growing capacity to deliver more of the Service's third-class advertising mail. According to Postal Service data, second-class mail generally is not protected under the Statutes but most third-class mail pieces meet the definition of a letter. However, the Statutes and Service regulations allow private firms to deliver unaddressed advertising pieces, provided they are not put in private mailboxes. We identified 375 firms that already deliver some advertisements in 47 states, most of which began operating within the last 8 years. Increasingly, many of these firms are participating in national alliances to broaden their delivery networks. We estimated that the Service, however, still delivers about 95 percent of advertising mail. However, the Postal Service believes that competition for advertising mail delivery could change quickly if the Statutes were to be relaxed and if alternate delivery firms and private mail-sorting firms combined their efforts to compete with the Service.

Our analysis of the Service's competition showed that if the Private Express Statutes were to be relaxed or repealed, Priority Mail would be most susceptible to private delivery. The potential effects of losing some First-Class, Priority, and third-class mail would vary because of differences in their volumes and in the net revenues generated by each of those three mail streams. The Service's future mail volumes cannot be projected with precision for a variety of reasons, some of which are discussed in volume II. Accordingly, we made no predictions of what the Service's future mail volumes will be. Rather, we provide estimates of the possible financial effects using a range of assumed percentage losses for First-Class, third-class, and Priority Mail. The estimates are provided to show what might be the effects on the Service's rates if it were to experience various volume losses.

For example, on the basis of the Service's 1995 revenue and cost data, an assumed 50-percent loss of Priority Mail volume in 1995 would not have resulted in an increase of the 32-cent First-Class letter rate. In contrast, if the Service's First-Class letter mail volume had been 25 percent lower in fiscal year 1995, the basic First-Class letter rate today would have needed to increase to 35 rather than 32 cents. This difference is due to the critical importance of First-Class letter volume to covering the Service's overall operating costs. Whether the Service will lose significant mail volumes in the future is unknown, and we made estimates to show how a variety of factors, such as its ability to reduce labor costs in line with reduced mail volumes and revenues, could affect the basic letter rate and the Service's other rates.

Although circumstances differ in each country, several countries, including Canada, Australia, New Zealand, and various European countries, have instituted what have been described as progressive reforms, in part to allow both their postal administrations and private delivery firms greater freedom to compete for mail delivery. Governments in these countries have continued to require mail delivery service to be provided widely and have at times taken steps following postal reform to ensure that such services are continued, such as entering into agreements with the postal administration. Postal administrations in some countries are relatively unconstrained in setting rates for certain mail delivery services, such as those subject to competition from private delivery firms. Some of these countries have eliminated or reduced the scope of their mail monopolies. Some other countries define letter mail monopolies according to specific, measurable characteristics of a letter, e.g., price or weight. This is in contrast to the Service's definition of a letter, which is based primarily on its content. The Service has used a minimum dollar threshold for private delivery of only extremely urgent letters, which accounted for less than 1 percent of its total revenue in fiscal year 1995.

A number of issues will be important in any consideration of legislative proposals to change the Statutes. These include the need to recognize the Statutes' underlying purpose and—assuming a continued commitment to this purpose—to determine how changes may affect universal mail service and uniform rates for some letters. Further, since the Statutes and other provisions of the 1970 Act are interrelated, changes in the Statutes to permit greater competition may necessitate consideration of other provisions, such as existing requirements for outside review of the Service's proposed postage rate changes. Also, changing the Statutes could affect not just the Postal Service but various other parties as well. For example, provisions such as the monopoly restrictions and the mailbox restriction may give the Service advantages over its competitors. Therefore, in considering possible changes, it is important to take into account the possible consequences for all stakeholders, including not only the Service but also the American public and the Service's competitors.

The Service Considers the Statutes Necessary to Support Public Service Mandates

The basic purpose of the letter mail monopoly has not changed in more than 200 years. That purpose is to ensure that the Postal Service has sufficient revenues to carry out its public service mandates, including regular mail delivery service (typically 6 days a week) to all communities. The mailbox restrictions also protect the Service's revenue as well as increase the security of the mail by limiting legal access to mailboxes.

Unlike its competitors, the Service has certain financial advantages, such as no requirement to pay income taxes and does not provide a return (e.g., dividends) to shareholders. However, it must also meet specific public service obligations and its ability to control operating costs and set postage rates competitively is constrained by law. It is not chartered or empowered to compete with private firms but rather is mandated to function as a public enterprise and provide mail service to all communities, not just those that are profitable to serve.

Given its competitive environment and operating constraints, the Service has changed postage rates to recognize some of the variations in the cost of handling letters. Consequently, postage rates overall, including First-Class letter mail rates, have become less uniform since 1970. To illustrate, in 1970, First-Class mail had just two 1-ounce rates: 8 cents for regular mail and 11 cents for air mail. In 1995, First-Class mail had 8 rates. The rates now vary depending on such things as whether large mailers participate with the Service in "worksharing." For a First-Class letter weighing up to 1 ounce, the worksharing rates range from 25.4 to 30.5 cents, compared to the 32-cent base rate.[2] Unlike contract rates that private carriers negotiate with individual customers, these rates are available to all qualifying mailers. In 1970, no such discounts were offered to any mailers.

Maintaining the current post office infrastructure also has become more expensive. This has occurred, in part, because of changes in the overall mix of mail. The volume of residential services, such as personal correspondence and stamp sales handled at post offices, has declined, while business volume has increased. For example, in 1995, bulk advertising mail was a much higher percentage of total mail volume than in 1970. Bulk mail typically is accepted at the Service's mail processing plants rather than at post offices.

[2]Effective July 1, 1996, discounts for worksharing changed as a result of a mail reclassification decision. For a First-Class letter weighing up to 1 ounce, the new worksharing rates range from 23 cents to 29.5 cents.

The effects of these changes in mail mix can be seen in the financial operations of the Service's post offices. According to Service data, of the 39,149[3] post offices it operated in fiscal year 1995, 17,702 (about 45 percent) reported taking in annual revenues that were lower than their aggregate expenses for the same year by about $1.1 billion. The Service is taking steps to upgrade many post offices and make them more accessible to customers. However, the 1970 Act contains detailed criteria and procedures that the Service must follow to close a post office, such as announcing a proposed closing and providing time for anyone affected to appeal the action to the Postal Rate Commission.

Where private delivery has been permitted, the Service often has been unable to compete effectively because it charged higher prices or provided fewer or less dependable services than its competitors. Private carriers often use negotiated sales agreements to offer their customers lower rates and a broader range of services for overnight letters and packages as well as 2-day and 3-day package deliveries. Therefore, if the Statutes are relaxed to allow greater competition for letter mail delivery, the Service could lose more business to private firms unless it reduces its prices and improves the quality of its services. If the Service loses more business to private firms, it is concerned that its ability to provide the services mandated in the 1970 Act could be jeopardized. Its concern is heightened by anticipated losses of business mail volumes to electronic communications.

Limited Enforcement of Statutes

Despite criminal sanctions for violations, enforcement of the Statutes rarely occurs and has proven to be problematic. In response to pressure from mailers and competitors, a bill (S. 1541, 103d Cong., 1st Sess. (1993))[4] was introduced in October 1993 to limit the Service's authority to fine or otherwise penalize mailers who used private carriers. Also in response to this pressure, the Service has not initiated a compliance audit against any mailer since 1994. Limited available data suggest that violations of the Statutes may be common. For example, the Postal Inspection Service completed audits of 62 mailers between October 1988 and June 1994. It found that 39 (63 percent) had violated the Statutes.[5]

[3]Of the 39,149 post offices operated in fiscal year 1995, 10,757 were small stations, branches and community post offices.

[4]This bill was not enacted.

[5]As a result of the audits, most of the mailers stopped using private carriers for nonurgent letters. However, 13 mailers continued to use private carriers and had paid the Service $1.2 million as postage on nonurgent letters sent by private carriers ($989,000 of which was paid by one company).

The Service believes, nonetheless, that the Statutes remain a useful and necessary deterrent to widespread use of private firms for letter delivery, and it now relies primarily on education as the principal means of encouraging compliance. The Service has assigned primary responsibility for public education to its marketing staff.

Authority to Suspend the Statutes Has Been Questioned

At times, the Service has yielded to pressure from competitors and mailers to allow more private letter delivery by issuing regulations to suspend the Statutes for certain types of letters. Several parties, such as the Air Couriers Conference of America[6] and Postal Rate Commission staff, have questioned whether Congress intended that the Service allow more delivery of private letters by suspending provisions of the criminal statutes, thereby allowing more private letter delivery.

The Service believes that the Statutes allow the Postmaster General to use such authority to permit private delivery of specified letters. However, some private sector competitors disagree with the Service. They are concerned that if private delivery of certain letters is only authorized administratively, the Service could, at any time, modify the regulations and restrict or eliminate competitors' authority to continue delivering such letters.

Economic Theory Cited for the Statutes Questioned

The restrictions on private delivery contained in the Statutes have been defended by a number of parties, including the Kappel[7] Commission, the Board of Governors in its 1973 recommendation to Congress, and some experts on the economics of postal services. These parties usually offer one or more of three basic justifications:

- A single provider, currently the Postal Service, can operate at a lower total cost to the nation than multiple suppliers can.
- Without restrictions on private delivery, "cream-skimming" by private competitors in the most profitable postal markets would undermine the Service's ability to provide universal service at reasonable, uniform rates.

[6]The Air Courier Conference of America is a trade association whose member firms compete with the Postal Service.

[7]President Lyndon Johnson appointed the Commission on Postal Organization, which was headed by Mr. Frederick Kappel and known as the Kappel Commission, to determine whether the postal system was capable of meeting the demands of the nation's growing economy and expanding population. Towards Postal Excellence: The Report of the President's Commission on Postal Organization, President's Commission on Postal Organization, (Washington, DC: Government Printing Office, June 1968).

- Postal services, historically, have been viewed as so important to binding the nation together that they should be essentially immune to disruption by labor disputes, bankruptcy, and other difficulties that private businesses face, regardless of whether this minimizes the cost to hard-to-serve customers or to the nation as a whole. In other words, the Service may minimize the cost to hard-to-serve customers, even if it does not minimize cost to the nation as a whole.

The Postal Service believes that the above justifications remain valid today. However, several federal agencies, some of the Service's largest customers and competitors, and many economists and other experts outside the Service question the justifications, either because they do not consider the policy goals (e.g., uniform rates) very important; or because they do not believe, as an empirical matter, that the Statutes are the best way of achieving them.

Relevant literature shows that various economic arguments for and against the statutory restrictions on postal services have been made and debated. For example, many economists who have studied the postal monopoly seem to agree that mail delivery has more natural monopoly characteristics, i.e., lower unit cost per delivery as mail volumes increase, than other postal functions, such as transporting and sorting the mail. Those who argue that mail delivery should be treated as a natural monopoly suggest that with appropriate regulation, a single supplier of mail delivery services—but not necessarily other postal functions—would best serve the public interest, i.e., result in the lowest overall cost to postal customers. Others argue that if mail delivery reflects natural monopoly characteristics, a single service provider would emerge under free market conditions and deliver at the lowest possible cost.[8] (See vol. II, ch. 2.)

Competition for Mail Delivery Services Has Grown Substantially Since 1971

Even though the Statutes have remained largely intact, numerous national and local mail delivery firms are now in business. Moreover, their numbers have increased, as have the volumes and variety of mail they deliver. Generally, the private firms that we studied can be separated into two groups, based on the types of delivery services they offer. One group primarily delivers urgent (overnight) mail and 2-day and 3-day (also called deferred) letters and parcels, all of which generally are referred to as expedited mail. The other group delivers unaddressed advertising circulars, periodicals, or both. Together, these groups compete on a local,

[8]In this situation, many economists argue that some regulation may still be necessary to ensure that the lower costs are passed along to the public.

national, and international basis for portions of markets previously served largely or exclusively by the Postal Service.

Priority Mail Is Currently Subject to Strong Competition

The Postal Service's strongest competitors are five national firms that offer expedited or parcel delivery services, including deferred package delivery services. Only one of these firms was operating in 1970, and most (three of five) entered the overnight package business after the Service suspended the Statutes for extremely urgent letters in 1979.

All but one of these five competitors offered deferred package delivery services in 1995. Most were adding other services, such as same-day delivery nationwide, at the time of our review. None of those five firms disclosed detailed operating data by product line or type of service. However, we used publicly available data to compare their services with similar services offered by the Postal Service. As shown in figure 2, three of these five competitors offered or planned to offer the same range of expedited letter and parcel delivery services as the Postal Service offers, except for deferred letters. The Services regulations permit private delivery of deferred letters under the urgency requirement, if the rate for such delivery is twice the applicable First-Class rate, or $3.00, whichever is greater.

Figure 2: Comparison of Services Offered or Planned by Expedited and Parcel Delivery Competitors

Carrier	Sameday Express	Overnight Letters	Overnight Packages	Deferred Letters	Deferred Packages	Ground Parcels
Postal Service	●[a]	●	●	●	●	●
Airborne Express	●	●	●	□	●	□
DHL Worldwide	●	●	●	□	□	□
Federal Express	●	●	●	□	●	□[b]
Roadway Package System	□	□	□	□	●	●
United Parcel Service	●	●	●	●	●	●

Legend

● Yes
□ No

[a]Available only between selected airports.
[b]Federal Express plans to offer a ground parcel service in 1996.

Source: GAO analysis of industry data.

The five private firms and the Service view deferred (second- and third-day) deliveries as a fast-growing market. As indicated in figure 2, four of the five private firms offered deferred package service, and one of those four also published rates for deferred letter service.[9] If the Statutes were revised or repealed to permit private carriers to deliver deferred letter mail at lower rates than is now required, it appears others could add letters to their existing services with relative ease.

The Service's Priority Mail is most comparable to the deferred services offered by the private delivery firms we reviewed. Priority mail is a heavier weight (more than 11 ounces) subclass of the Service's First-Class mail and is delivered at $3.00 per piece up to 2 pounds, with rates increasing to $77.09 on the basis of distance (up to 8 zones) and weight (up to 70 pounds). It is among the Service's fastest growing product lines and one of its most profitable as measured in net revenue per piece. The Service does not know how much Priority Mail is protected by the Statutes because

[9]The price charged by United Parcel Service for deferred letter service in 1995 was $6 for letters up to 8 ounces, or twice the minimum Priority Mail rate.

such mail is typically sealed from inspection. Service officials believe that a significant portion and possibly up to 70 percent of the Priority Mail volume is letter mail, thus protected by the Statutes.

Unlike its competitors, the Postal Service cannot contract with individual customers to offer negotiated or volume rate discounts. Many of the Service's customers told us that the Service is less timely and dependable than its competitors. For example, under a contract awarded in 1990 to Federal Express (FedEx), the federal government obtains overnight letter and small package delivery anywhere in the United States, including Alaska, Hawaii, and Puerto Rico. Typically, that carrier's monthly "on-time" delivery performance for government clients has been slightly better than the Service's Express Mail performance and much better than the Priority Mail performance. Further, the Federal Express government rate was much less than the Service's Express Mail rate but higher than the minimum Priority Mail rate. (See table 1.)

Table 1: Comparison of Federal Express Government Contract Rates and Delivery Performance to Similar Postal Service Products

Carrier	Range of rates for 8-ounce letter to 2-pound packages	On-time delivery performance for 1995
Federal Express	$3.75 - 3.99	93-97 percent[a]
Postal Service Express Mail	$10.75 - 15.00	95 percent
Postal Service Priority Mail	$3.00	82 percent[b]

[a]Federal Express reported on-time deliveries to the General Services Administration (GSA), which administers the governmentwide contract, on a monthly basis. Because of partial government shut-downs that hampered normal delivery operations, on-time performance for November and December 1995 are excluded.

[b]This represents the on-time rate reported by the Postal Service for Priority Mail pieces subject to its second-day delivery standard. The on-time performance for pieces subject to a third-day delivery standard (a much smaller portion of overall Priority Mail volume) deliveries was 93 percent.

Source: Compiled by GAO from GSA and Postal Service data.

GSA competitively awarded a new contract, effective August 16, 1996, to replace the 1990 contract. FedEx is again the contractor and is to provide both overnight letter and 2-day package services. The new overnight rates are lower than those shown in table 1. For example, the minimum overnight letter rate dropped from $3.75 per piece to $3.45. The rates for

1- and 2-pound packages, respectively, are $3.50 and $3.57 for overnight service and $3.40 and $3.45 for 2-day service.

We estimated that the Service's five principal competitors accounted for more than 85 percent of all U.S. domestic expedited and parcel delivery revenues, compared to about 15 percent for the Postal Service. These competitors offer delivery services on demand to virtually all domestic U.S. addresses. They also have lobbied Congress to allow more private letter delivery. These firms are not constrained to any great extent by the prohibition on using mailboxes because the items they deliver typically require a signature, are too large to fit into residential mailboxes, or are delivered inside to businesses. However, if Congress allows more private letter delivery, these constraints may become more important because the firms might find the use of mailboxes desirable to improve competitiveness.

Some Other Letter Mail Is Subject to Rapidly Growing Competition

Postal Service regulations consider advertising matter under 24 pages addressed to a specific person or occupant as letter mail and subject to the Statutes. Even so, 375 firms operate in 47 states and compete in a fast-growing advertising mail market, a subscriber publication delivery market, or both. Mostly small local firms, they are known collectively as the "alternate delivery industry," and they compete with the Postal Service for delivery of its third-class advertising mail and second-class publications mail. Collectively, these firms represent a significant and growing source of additional competition for private mail delivery.

The number of such firms more than tripled (from 108 to 375) from 1982 to 1995. Of the 375 firms, 226 were established between 1988 to 1993. To develop and sustain profitable delivery operations, these firms have increased the volume and variety of items they deliver. Many newspaper publishers have established alternate delivery operations to serve their advertisers better, reduce mail costs, and improve delivery service. In addition, many alternate delivery firms have formed or joined nationwide alliances to market their services more effectively to national publishers or advertisers.

On the basis of the limited data available, we estimated that the Postal Service still delivers about 95 and 96 percent of the total volume of all periodical and advertising mail, respectively. However, representatives of several large mailer groups whose members depend heavily on third-class mail indicated that many of their members would be willing to shift some portion of their mail to private carriers if permitted to do so.

According to an alternate delivery trade association, its member firms deliver circulars, tabloids, magazines, catalogues, directories, flyers, samples, and other printed materials and advertisements, primarily from businesses to households. The firms we studied target and deliver advertisements to households without using an address or mailbox. Items may be delivered to all households in a particular neighborhood and hung on a door knob or from a hook on a mailbox post, placed on a front porch or in a separate delivery tube, or tossed onto driveways or walkways.

Although alternate delivery companies compete with the Postal Service primarily to deliver third-class advertising and second-class publications mail, some First-Class mailers also indicated a willingness to use such firms. However, restrictions on mailbox access make delivery of First-Class mail by private firms less likely than delivery of third-class mail.

Possible Financial Effects on the Postal Service of Reduced Letter Mail Volumes

We judgmentally assessed the relative risk of the Service losing mail volume to private delivery firms, primarily by reviewing private sector delivery capacity and interviewing representatives of delivery organizations representing most of the nation's business and institutional mailers. We also assessed the likely impact of various mail volume losses on the Service's postage rates. To do this, we assumed that if the Service experiences any significant loss of mail volume in the future, this would result in higher postage rates, not in reduced services nor increased appropriated funds to the Postal Service. We used revenue, cost, and postage rate data provided to us by the Commission, which it had used for setting the current 32-cent basic letter mail rate and other new postal rates that became effective in January 1995. We supplemented our analysis of historical ratemaking data by using a financial forecasting model that presented estimates for 10 future years. This model was developed by Price Waterhouse LLP (Price Waterhouse) under contract with the Postal Service.

In assessing the risk of volume loss, we compared various factors, such as private delivery capacity, mailer and carrier interests, and service performance, for the letter mail classes and subclasses against each other and then judgmentally assigned a risk level ranging from "low" to "high." We compared the estimated financial effects, e.g, relative change in net revenue and the basic letter rate, of volume losses in each of those categories against each other to similarly characterize the likely impact on the Service. The results of our assessments are shown in table 2.

Table 2: Assessment of Relative Risk and Likely Financial Impact of Changing the Private Express Statutes

Mail class/subclass	Relative risk of loss[a]	Likely financial impact
Priority Mail[b]	High	Low
Other First-Class letters	Low	High
Third-class letters	Low	Medium

[a]This risk of loss is related only to direct competition from private delivery firms and does not include possible volume losses from diversion of mail to electronic communications.

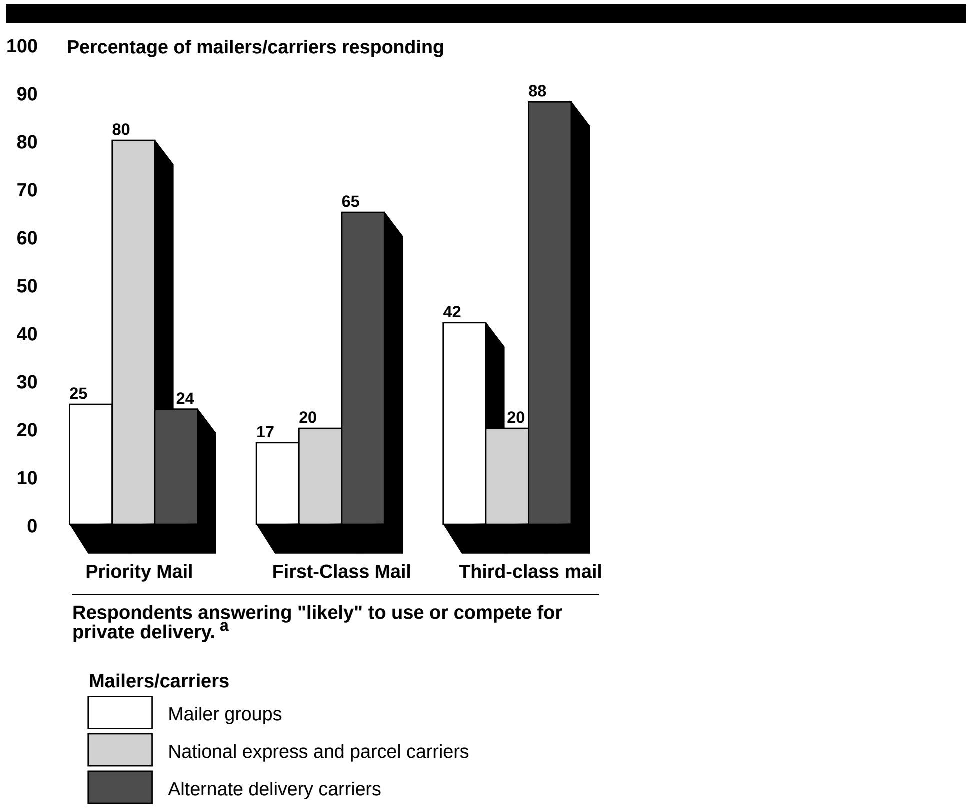
[b]Priority Mail pieces weighing 12 ounces and over are generally considered as packages and, therefore, not protected by the statutes.

Source: GAO analysis of available data.

Priority Mail Is Most Susceptible to Private Delivery

Given current private delivery capacity and prices, Priority Mail letters would be most at risk if the Statutes were to be relaxed. Some First-Class and third-class letters also could be diverted to private delivery, but the percentage of volume losses probably would be much lower than for Priority Mail letters, as figure 3 shows.

Figure 3: Mailer and Carrier Interest in Private Delivery by Letter Mail Class and Subclass



[a]Each group was separately asked about their interest in mailing or delivering (1) Priority Mail, (2) First-Class mail, and (3) third-class mail. Only the "Likely" response is shown (i.e., "very likely" and "somewhat likely" combined).

Source: GAO interviews.

Most nationwide private carriers we interviewed said they would be ready and willing to deliver letters designated as Priority Mail if the Statutes were relaxed. Given the success of nationwide carriers when competition with the Service has been permitted, it is likely that large numbers of mailers could shift some portion of their Priority Mail letters to private carriers almost immediately if the Statutes were to be changed. In part, this is because mailers perceive the quality of private carriers' services to be better than that of the Service. If private carriers were not required to charge at least twice the applicable $3 Priority Mail rate for deferred letter delivery, they could offer contract rates that could be more competitive with the Service's rates. This possibility, when combined with customers' perceptions of the differences in service quality, creates an even greater risk of Priority Mail volume losses for the Service.

Most mailers were satisfied with both First-Class postage rates and service. Our interviews indicated that unless both the Statutes were relaxed and the mailbox access restrictions were lifted, mailers likely would not shift much First-Class mail to private delivery. Most expedited letter and parcel carriers with existing, nationwide delivery capabilities expressed little interest in pursuing residential, First-Class letter mail delivery. However, some local, alternate delivery carriers indicated that they might pursue some First-Class mail deliveries if the Statutes were relaxed.

Most third-class mailers we interviewed said they were not fully satisfied with postage rates[10] or the timeliness and dependability of third-class mail delivery. Many said they would likely divert some third-class mail to private firms if the Statutes were relaxed. Similarly, most alternate delivery carriers said that they would likely pursue additional third-class, business-to-household mail deliveries. However, the collective capacity of the alternate delivery industry is limited when compared to the Postal Service's capacity. As previously indicated, we estimated that in 1995 the Postal Service delivered about 95 percent of all periodical and advertising mail. Even so, the Service faces a lower risk of third-class mail losses to private firms when compared to the possible Priority Mail losses.

First-Class Mail Losses Would Have Greatest Financial Effect

If some volume losses were to occur, the financial effects on the Service would vary greatly among classes of mail consisting largely of letters. According to Service revenue and cost data, a loss of most or all Priority Mail or a loss of, say, 25 percent of third-class mail would have less effect on postage rates than a 5- to 10-percent loss of First-Class letter volume. The Postal Service's "margin," i.e., the difference between the rate charged and the related cost, varies significantly among classes of mail. Because of this difference and the relative volumes of letters in the several classes, the financial effects on the Service of losing a portion of some classes of letter mail could be much greater than for other classes.

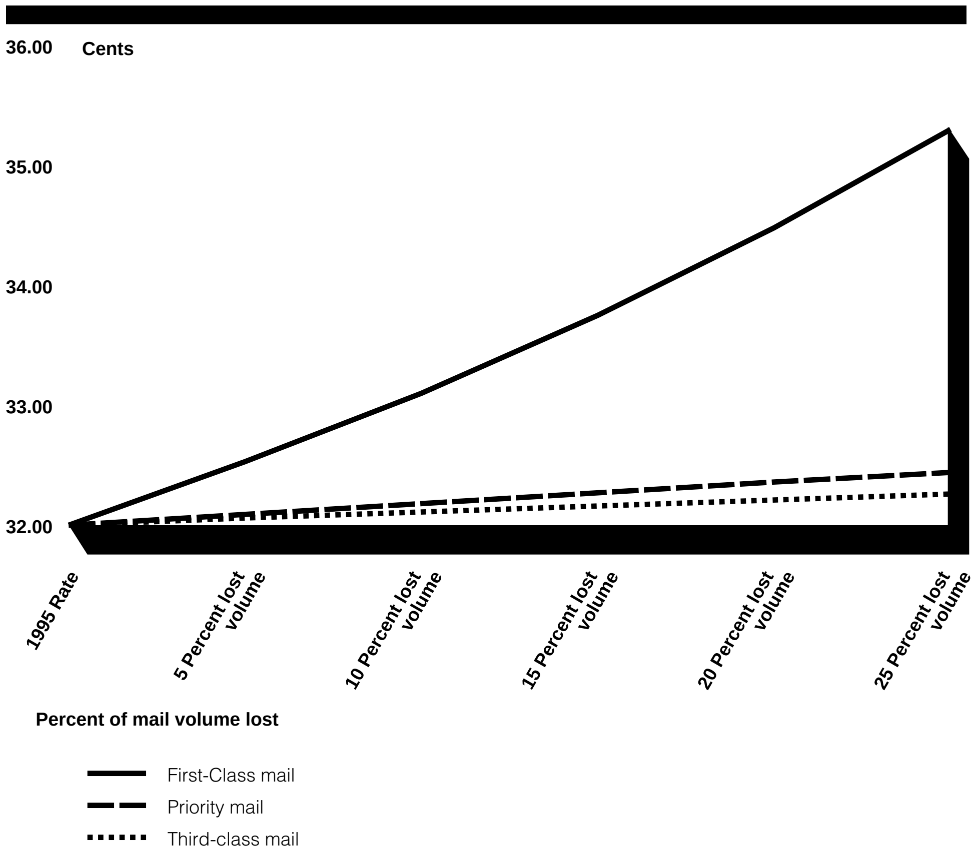
First-Class letter mail volume is critically important to the Service's overall revenue and its ability to cover operating costs. Most (88 percent) First-Class mail is lightweight (1 ounce or less) and is relatively easy for

[10]Effective July 1996, due to a reclassification of third-class mail, some third-class mailers who presort and prebarcode letters will be paying lower postage rates than those who do not presort and prebarcode letters.

the Service to sort with its automated equipment. According to the most recent rate case data (Docket R94-1), First-Class mail revenue was estimated to cover about $32 billion, or 66 percent, of the Service's total operating cost and $11.7 billion, or 71 percent, of its total institutional cost (overhead) in fiscal year 1995.

At our request, the Postal Rate Commission and Price Waterhouse estimated the change in postage rates for all classes and subclasses of mail as well as the current basic letter rate of 32 cents (the postage for a First-Class letter weighing 1 ounce or less). Following our instructions, they assumed various hypothetical percentage losses of First-Class, Priority, and third-class mail volumes, which are largely made up of letters, in fiscal year 1995. We included the basic letter rate for analysis because the 1970 Act requires the Service to provide a uniform rate for at least one class of sealed envelopes, such as First-Class letters. As shown in figure 4, the effects of different First-Class letter volume losses—ranging from 5 percent up to 25 percent—on the Service's current basic letter mail rate would be more significant than if the same percentage losses occurred for Priority Mail and third-class letters in fiscal year 1995.

Figure 4: Estimated Effects of Mail Volume Losses Ranging From 5 Percent Up to 25 Percent in Fiscal Year 1995 on the Basic Letter Rate



Note: This analysis assumes that the Postal Service would not incur the attributable cost associated with the volume losses. The loss in overhead cost contribution resulting from the volume losses was redistributed to mail classes on the same basis as their share of contribution to overhead costs in the R94-1 rate case, except that no redistribution of such cost was made to nonprofit mail.

The Postal Rate Commission did not consider the second-order volume loss that would result from the higher rates required to make up for the lost institutional cost contribution. See volume II, appendix I, for additional information on our methodology and assumptions.

Source: Postal Service and Postal Rate Commission data used in setting postage rates effective January 1995 (Postage Rate and Fee Changes, 1994, Docket No. R94-1, Nov. 30, 1994).

As indicated in figure 4, a 25-percent loss of First-Class mail volume in fiscal year 1995 would have resulted in the need to increase the 32-cent basic letter rate by 3 cents to 35 cents. By way of comparison, since 1970, the First-Class stamp price has increased 9 times; each increase ranged from 2 to 4 cents.

Although we have estimated the effects on the 32-cent stamp, the projected impact on revenue and rates associated with these volume losses could be substantial for all classes. For example, assuming a 25-percent loss each in Priority, First-Class, and third-class mail pieces in 1995, estimated revenue losses could have ranged from $690 million for Priority Mail up to $8.1 billion for First-Class mail. (See table 3.)

Table 3: Estimated Effects of Various Mail Volume Losses on Postal Revenue and the Basic Letter Rate[a]

Mail class and assumed percentage loss	Estimated revenue loss as a result of lost volume (millions)	Estimated First-Class stamp price needed to cover postal costs assuming lost mail volume (cents)
First-Class mail		
5	$ 1,618	33
10	3,236	33
15	4,855	34
20	6,473	35
25	8,091	35
Priority Mail		
5	138	32
10	276	32
15	414	32
20	553	32
25	691	32
Third-class mail		
5	330	32
10	660	32
15	990	32
20	1,320	32
25	1,650	33

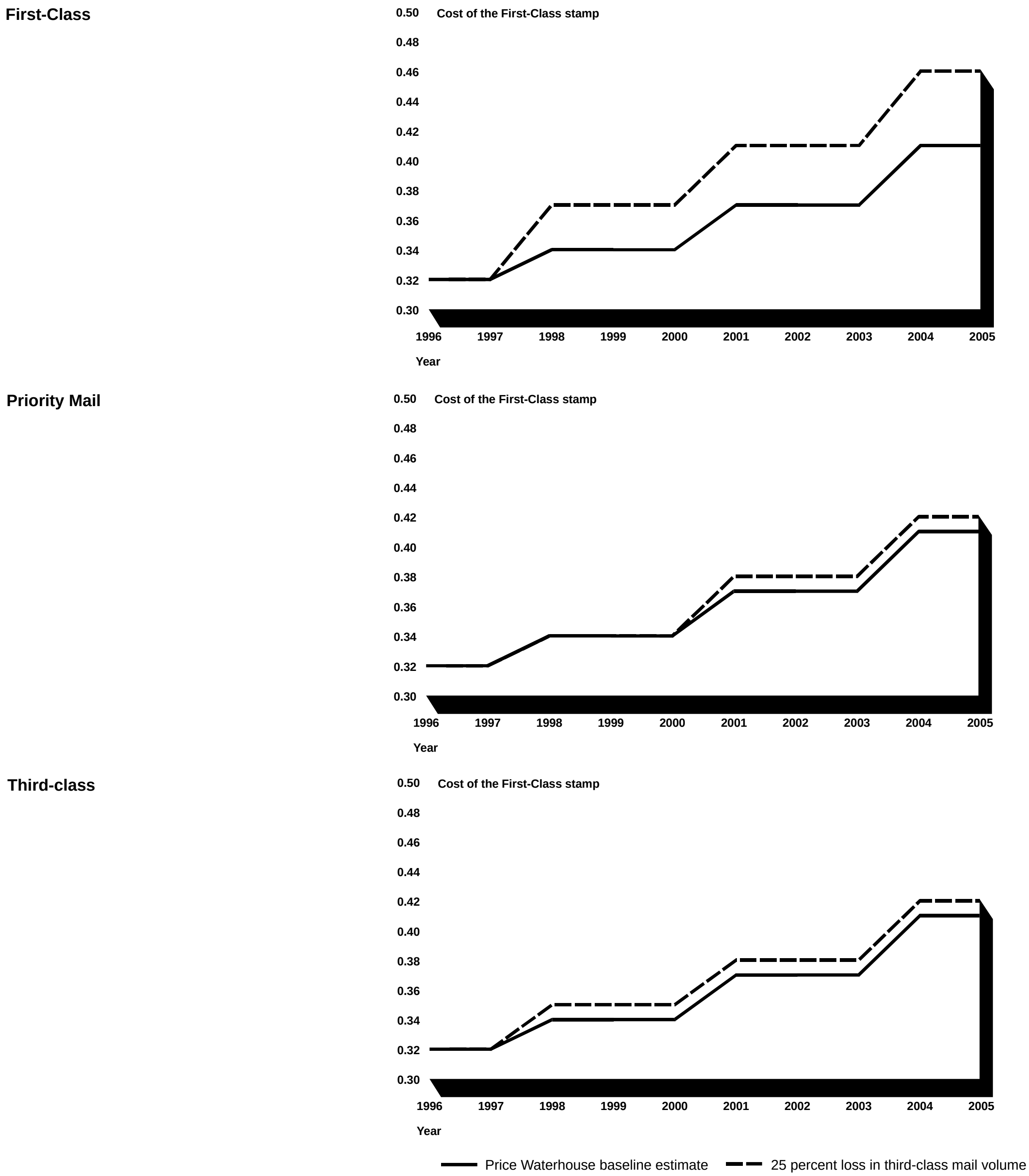
[a]At our request, the Postal Rate Commission estimated the change in postage rates assuming losses of First-Class, Priority, and third-class mail in 5-percent increments from 5 percent up to 25 percent. See appendix I for additional assumptions used by the model.

Source: Postal Service and Postal Rate Commission data used in setting postage rates effective January 1995 (Postage Rate and Fee Changes, 1994, Docket No. R94-1, Nov. 30, 1994).

We assumed for our estimates that the costs specifically attributed by the Service to these lost mail volumes would no longer be incurred. If the Service is able to reduce not only attributable costs but also some institutional costs to offset revenue losses, the effects of any losses of future mail volumes could be less than we have estimated. Conversely, to the extent that the Service is unable to reduce attributable costs enough to offset the related revenue losses, the effect on its rates would be greater than indicated.

Price Waterhouse used its model to estimate the effects of varying percentages of mail volume losses on revenue, cost, and postage rates over a 10-year period, 1996 through 2005. For this longer period, the model shows that the relative effects on the basic 32-cent letter rate for mail volume losses in the several classes are similar to those estimates made on the basis of the recent ratemaking data (Docket R94-1). A loss of 25 percent of First-Class mail volume could have a much greater effect on this rate than the same percentage loss of Priority Mail and third-class mail volumes. Specifically, the letter mail rate is estimated to be 41 cents in 2005, according to the model's baseline assumptions. The 41-cent rate would need to increase to 46 cents in 2005 assuming a 25-percent loss of First-Class mail volume. The rate would need to increase to only 42 cents in 2005, assuming a 25-percent loss of Priority Mail volume or third-class volume. (See fig. 5.)

Figure 5: Estimated Effect on the Basic Letter Rate, Assuming a 25-Percent Loss of First-Class Mail Pieces, Priority Mail Pieces, and Third-Class Mail Pieces, 1996-2005



(Figure notes on next page)

Note: We assumed a 5-percent loss of First-Class volume each year from 1996 through 2000 and that other volumes will increase as estimated by Price Waterhouse. Also, postage rate increases are assumed to occur in 1997, 2000, and 2002.

See appendix I, volume II, for additional information on the methodology and assumptions used for this analysis.

Source: Postal Service data and Price Waterhouse model.

Many Different Factors Could Affect the Ultimate Impact of Changes in the Statutes

A range of factors relating to the Service's (1) future mail volumes, (2) cost growth, and (3) service quality and ratemaking initiatives could lead to increases or decreases in future mail volumes. The effects of these factors are unknown, making it difficult to estimate how a change in the Statutes might affect the Service's revenues and rates.

Future Mail Volumes Are Unknown

Although the Service has faced competition for many years, it also has experienced substantial growth in overall mail volume. This growth has occurred despite both new communications technology, including facsimiles, desk-top computers, and the Internet's World Wide Web, as well as suspensions of the Statutes under which private companies now carry most extremely urgent (overnight) domestic and outbound U.S. international mail.

Notwithstanding the historical growth in mail volume and whether or not the Statutes remain intact, the Service anticipates losses of some First-Class, Priority, and third-class mail volumes primarily through diversion to electronic communications. According to the Postal Service, six of its seven "product lines"—correspondence and transactions, expedited mail, publications, advertising, standard packages, and international mail—are subject to competition from some form of electronic communication, private message and package delivery firms, or both. Its remaining and only nondelivery product, retail services, also faces increasing competition from private "postal" service firms.

Further, Service officials believe that private firms would compete for delivery of large quantities of presorted, prebarcoded First-Class and third-class mail. They said that such mail is more profitable to deliver and, therefore, more attractive to competitors than smaller quantities of mail for which customers do little or no presorting or prebarcoding. Further, the Service believes that if the Statutes are relaxed, presort bureaus and alternate delivery firms would develop alliances or in some other way combine these efforts to prepare and deliver letter mail in competition with the Postal Service. It believes that this development would occur quickly after any change in the Statute.

Cost Growth Has Continued

With competition for delivery services increasing, the Service's employment levels and related labor costs have continued to grow since 1970. We previously reported[11] that employee pay and benefits account for the vast majority of the Service's costs. Labor costs, representing pay and benefits for nonbargaining executives, managers, and supervisors, and bargaining craft employees, were over 80 percent of the Service's costs in 1995. That percentage has remained virtually unchanged since 1969, the year before passage of the 1970 Act. This trend has continued even though the Service has invested or plans to invest more than $5 billion in automation equipment since the early 1980s to reduce labor costs. Between April 1993 and November 1995, after the Service had largely completed a downsizing effort, overall postal employment (career and noncareer) grew by about 10 percent, from 782,000 to 855,000 employees.[12] Almost all (98.6 percent) of this 73,000 increase represented career employees, and more than two-thirds (69 percent) represented career clerk and city carrier employment.

The vast majority of the Service's craft employees, those who collect, sort, and deliver mail, are protected from layoffs.[13] This protection could result in more contentious labor contract negotiations and delay the Service in reducing its work force and labor costs to offset the effects of any significant downturn in mail volume.

The estimates of mail volume losses shown previously (see figs. 4 and 5) assume that the Service's attributable costs would decrease in proportion to revenue decreases. Under this assumption, attributable costs would be expected to drop by 1 percent for each 1-percent drop in postal revenue. We believe that this assumption is reasonable, particularly if any significant reduction in the Service's mail volume were to occur over several years, because in some earlier years the Service was able to make substantial work force reductions through attrition as well as buyouts and other incentives.

[11]See U.S. Postal Service: Labor-Management Problems Persist on the Workroom Floor (GAO/GGD-94-201A/B, September 1994).

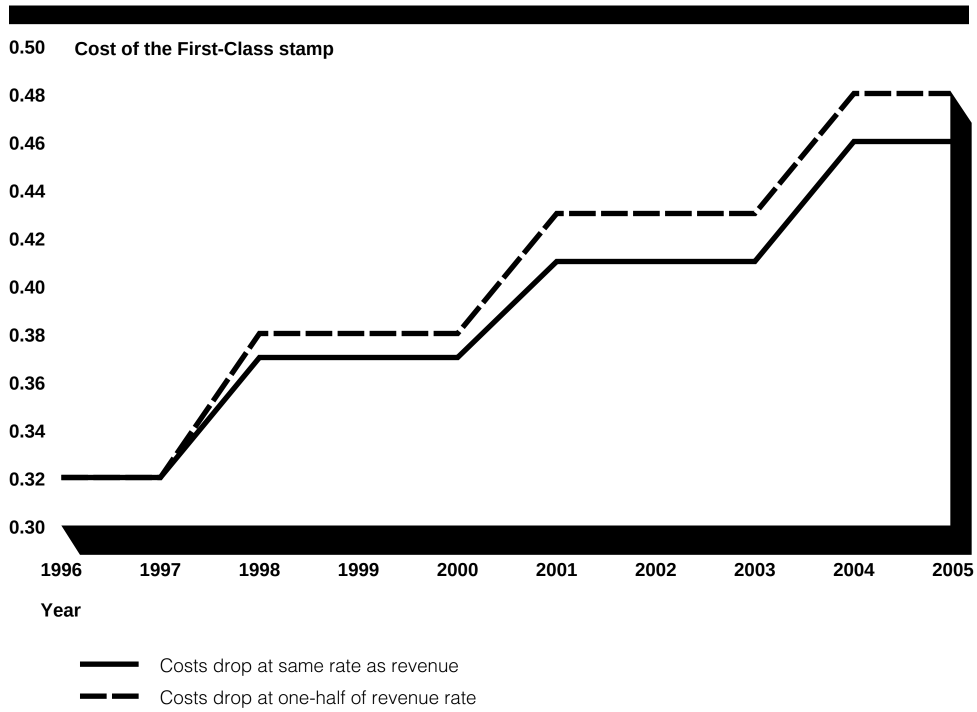
[12]By June 1996, overall career and noncareer postal employment had grown to 869,242.

[13]Contracts between the Service and its major unions generally prohibit the layoff of career employees who have at least 6 years of employment with the Service.

For example, during the 4 years from May 1989 through April 1993, the Service reduced the career work force from about 774,000 to about 667,000, or almost 14 percent. This reduction largely represented clerks, carriers, mail handlers, and other unionized employees. The reduction occurred during a period when the Service's cumulative growth in mail volume was about 12 percent. However, to improve mail service, the Service later added employees. Between April 1993 and November 1994, the career work force grew to about 740,000, or almost 11 percent.

The Service's labor costs have grown for various reasons, such as increases in wage rates and overtime as well as growth in total Postal employment. Therefore, the Service may not be able to reduce attributable costs at the same rate that revenue drops. Because of this uncertainty, we arranged through the Service to have Price Waterhouse estimate the basic postage rate (now 32 cents) assuming that attributable labor costs were to be reduced at only one-half the rate of postal revenue losses. Assuming a 25-percent loss of First-Class mail, the estimated increase in the basic letter rate would differ if the Service reduced attributable labor costs (1) at the same rate as revenue decreased and (2) at one-half that rate. In this scenario, the basic letter rate would need to increase from 32 cents in 1996 to 44 cents in 2005 if revenue and labor costs drop at the same rate, or 46 cents if labor costs drop at one-half the rate of revenue loss. (See fig. 6.)

Figure 6: Comparison of Increases in Basic Letter Rate Assuming a 25-Percent Loss of First-Class Mail Volume and Different Reductions in the Postal Service's Attributable Costs, 1996-2005



Note: See appendix I, volume II, for information on the methodology and assumptions used for this analysis.

Source: Postal Service data and Price Waterhouse model.

Improvement Initiatives Under Way

Recognizing the need to protect and increase its revenue, the Service has many initiatives under way to enable it to compete more successfully with private firms by improving existing services as well as offering new services. The Service recently began a top-down initiative to improve internal processes that affect customer satisfaction. Its on-time delivery rates for overnight, First-Class mail improved in 1995 and early 1996. In 1995, it established a new unit to compete more aggressively in the international mail markets, where the Service's postage rates are not subject to the Postal Rate Commission's approval. The Service and mailers recently began implementing a reclassification of mail that is expected to encourage mailers to prepare mail better and thereby reduce the cost to sort and deliver such mail. The Service has also invested in market and product research with a view toward offering new electronics-related services in the future. Many of these initiatives had just started at the time of our review. It is not yet clear how they may affect the Service's competitiveness. (See vol. II, ch. 4.)

Some Other Countries Require Universal Service but Have Eliminated or Narrowed Postal Monopolies

Many postal administrations around the world have mail monopolies to help meet universal letter delivery and other public service obligations. Many of the eight postal administrations[14] we reviewed have been reformed in the past 15 years to give them much greater freedom to operate like private businesses. In a recent study by Price Waterhouse, these postal administrations were described as among the "most progressive."[15] The governments in these countries have used several different approaches, such as periodic reviews of delivery practices and agreements between the governments and the postal administrations, to ensure the continuation of universal mail service after reform. The scope of our work did not include an evaluation of postal reforms in these countries. Comparisons are difficult to make given the greater size of the U.S. Postal Service. Nevertheless, as we previously testified, postal reforms in other countries do hold some relevance for the United States.[16]

A variety of conditions led to the postal reform in other countries. A key reason was increased competition in the delivery and communications markets. In response, governments in most of the eight countries have granted postal administrations greater commercial freedom to meet growing competition. Some foreign postal administrations have taken a range of actions to become more competitive, such as downsizing the work force; increasing productivity; making changes to the postal retail network; and pursuing initiatives to compete in electronic mail, facsimile, electronic bill payment, and other electronic communications services. As competitive pressures increase, some other countries are contemplating further postal reforms, including additional steps to narrow or eliminate postal monopolies.

Some of the countries we reviewed have redefined and limited their letter mail monopolies, and Sweden has eliminated the postal monopoly altogether. A common practice was to define the scope of the postal monopoly according to price, weight, urgency, or a combination of these

[14]Australia, France, Canada, Germany, the Netherlands, New Zealand, Sweden, and the United Kingdom.

[15]"A Strategic Review of Progressive Postal Administrations: Competition, Commercialization, and Deregulation" (Price Waterhouse LLP, February 1995).

[16]See U.S. Postal Service: A Look at Other Countries' Reform Efforts (GAO/T-GGD-96-60, January 25, 1996).

factors. For example, the British postal administration limits the monopoly to letter mail with postage up to 1£. This is in contrast to the definition of a letter in this country, where no measurable characteristics are used except for extremely urgent letters, for which the Service has suspended the Statutes. In 1979, the Service used a price limit as part of the criteria for suspending extremely urgent letters from the Statutes. Specifically, this limit provides that private firms may deliver letters if the price charged is at least twice the Service's First-Class postage rate or $3.00, whichever is greater. The Service believes this price limit—called the double-postage rule—is necessary to clearly distinguish those letters subject to the Statutes.

None of the eight countries had laws that give their postal administrations exclusive access to private mailboxes. However, practical limitations to mailbox access exist in some countries, such as post office boxes and locked mailboxes accessible only to the customer and the postal administration. (See vol. II, ch. 5.)

Issues Relevant to Proposed Changes to the Statutes

As it now operates, the Service has assumed two distinct roles as (1) a competitor with private delivery firms and (2) a federal entity established to provide universal mail service. Difficult policy issues arise out of these potentially conflicting roles, including (1) the extent to which the Private Express Statutes should restrict competition and (2) whether the Service could continue to provide universal service if the Statutes were relaxed.

The Service's principal response to the growth in private mail delivery has been to avoid mail volume losses by trying to compete more aggressively. It cannot, however, compete head-to-head because it is charged by law with fulfilling a public service mission. Many of the 1970 Act's provisions, such as those for setting postage rates and resolving collective bargaining disputes, are designed to enable the Service to accomplish its mission as a regulated entity that operates in a noncompetitive environment.

As the Service prepares to compete more effectively and pushes for greater freedom to compete, and as private capacity to deliver letters grows, the Statutes are likely to become more controversial. Calls for Congress to consider whether to modify the Statutes, or eventually eliminate them altogether, and make other changes in the 1970 Act are likely to become more intense.

A number of considerations are particularly relevant to proposals to change the Statutes. These include (1) their underlying purpose, (2) their relationship to other provisions of the 1970 Act, and (3) the possible consequences for various stakeholders.

The Statutes' Purpose

The Statutes' purpose is clear. They exist to help ensure that the Postal Service has enough revenue to provide universal letter mail service to the American people. The Service supports the view that it should continue to be the sole provider of letter mail services. However, the validity of this view has been questioned repeatedly since 1973 as the private mail delivery industry emerged and flourished, as economic theory and research evolved concerning the conditions under which monopoly services are supportable, as knowledge about the Service's operating costs increased, and as postal reform experience in other countries evolved.

Consequently, it is not clear whether the underlying economic basis for the Statutes cited by the Postal Service in 1973 and on later occasions remains valid today. Nor is it clear that economic theory alone should guide policy decisions on what roles the Postal Service and private firms should play. Insufficient data exist to measure and evaluate the total cost of mail services to the American public and how such costs might differ if multiple firms provided such services.

The Statutes' Relationship to Other Provisions of Law

The Statutes are but one of many interrelated provisions of the 1970 Act and other federal laws that, together, are intended to help ensure that the Service remains a viable entity for providing mail services to all communities and that the public interest is served.

Other provisions require that the Service's costs and rates be reviewed by the Postal Rate Commission. Proposed changes in postal rates can be contentious and can take up to 10 months to resolve. As we have reported,[17] two studies completed in fiscal year 1992 showed that this process possibly could be shortened and streamlined to be more responsive to the Service's current needs. However, the criteria and process for setting postage rates prescribed in the 1970 Act are relevant and important to achieving other objectives of the act. Two such objectives, which are fundamental to the Service's public service mission, are (1) that each class of mail bear only the direct and indirect postal costs

[17]These studies, one by the Institute of Public Administration and the other by a joint Postal Service and Commission task force, are discussed in our report U.S. Postal Service: Postal Ratemaking In Need of Change (GAO/GGD-96-8, Nov. 15, 1995).

attributable to that class and not others, and (2) that parties affected by changes in postage rates be given an opportunity to comment on such changes.

The Possible Consequences of Changing the Statutes

It is impossible to predict with certainty what the consequences might be should the Statutes be relaxed. The best available data indicate that a sweeping change of the Statutes that opens the Service's First-Class mail services to competition could affect postage revenue and rates severely. This prognosis, however, is subject to some critical assumptions, such as (1) the Service would not improve its service performance sufficiently to avoid large losses of mail volume to private firms and (2) firms now competing or those deciding to compete in the future would offer better prices or services than the Service.

Another assumption is that the consequences of a change in the Statutes would flow not only to the Service but to all stakeholders, including the American public, mailers, and competitors. Assuming a continued commitment to providing traditional mail service in all communities and to providing a reasonable and uniform First-Class postage rate, a key question is whether these goals are advanced by protecting the Service's mail volumes by law. If the Service could meet these public service obligations and if increased competition were permitted, the public could be free to choose less costly or higher quality services. It is important to consider how incremental changes might affect all stakeholders in determining whether to relax the Statutes.

There has been a general pattern among the other countries we reviewed of continuing to require universal service but also allowing greater competition for letter mail delivery. The scope of the monopoly as it relates to the definition of a letter is more clearly delineated in some other countries than in the United States. As we have stated, most other countries employ some combination of price and weight to define monopoly-protected letters, whereas the Service's definition relies mainly on content, except for extremely urgent letters.

The Service's 1979 regulations allow extremely urgent letters to be delivered by private firms if the price change is above a minimum dollar threshold. According to the Service, this threshold is necessary to provide clarity and thereby facilitate compliance. Neither the statutes nor the Service's regulations restricting private delivery of other letters include similar dollar or weight characteristics.

Scope and Methodology

Our review focused primarily on events and developments surrounding the Statutes during the approximately 25 years since the Postal Reorganization of 1970, which set up the U.S. Postal Service. We reviewed the legislative history of the Statutes and related laws and their implementation through Postal Service regulations; interviewed Postal Service officials at headquarters offices and field locations in Atlanta, GA; Chicago, IL; Dallas, TX; San Francisco, CA; and Jacksonville, FL; and reviewed relevant Postal Service data and reports. We examined records summarizing Postal Inspection Service audits of mailers' compliance with the Statutes and interviewed representatives of selected companies in Georgia and Alabama audited by the Postal Inspection Service.

Our work on the development of the private sector message and package delivery industry included interviews with representatives of private delivery firms, major trade associations and mailer groups, knowledgeable industry observers, and Postal Service and other government officials. We also reviewed available literature and analyzed relevant postal service and industry data.

To analyze the possible financial effects on the Service's revenue, costs, and postage rates if the Statutes are relaxed, we estimated the relative risk of the Service's letter mail stream, by class and subclass, primarily on the basis of interviews with current Service mailers and competitors. We also estimated the degree to which the Service's revenue and postage rates might have been affected if its estimated fiscal year 1995 letter mail volumes, by class and subclass, had been reduced by various percentages. For these estimates, we used Postal Service data that it had provided to the Commission in early 1994 to request new postage rates, including the 32-cent basic letter rate that became effective in January 1995. We also arranged with the Postal Service and its management consulting firm, Price Waterhouse, to develop estimates for us of possible changes in postage rates assuming that the Service's letter mail volumes were to be reduced by various percentages in future years.

We obtained information on postal administrations in other countries from several reports, including a February 1995 report prepared by Price Waterhouse, and interviewed officials of several other postal administrations; visited the Canada Post Corporation; and reviewed annual reports and various other documents provided by foreign postal administrations.

Our review was conducted primarily between May 1994 and February 1996 in accordance with generally accepted government auditing standards. (See vol. II, ch. 1.)

Agency Comments and Our Evaluation

We requested comments on a draft of volumes I and II of this report from the U.S. Postal Service and the Postal Rate Commission. The Postal Service responded in a letter, with enclosure, dated August 29, 1996. The letter is reprinted in appendix I of this volume, and our comments on the letter itself are provided below. Because the enclosure to the letter raised technical matters related to the content of volume II, the letter with the enclosure is also reprinted in appendix II of volume II, and our detailed comments on those technical matters are provided in chapter 6 of volume II.

The Commission did not provide written comments. However, Commission officials suggested several changes to volumes I and II of the draft to improve technical accuracy and completeness of the report. We incorporated those changes where appropriate.

The Postal Service said that our report presents credible information on the purpose and application of the Private Express Statutes and related regulations. However, the Service expressed concern that we had ventured into speculating about the possible financial effects of eliminating or substantially relaxing the Statutes. The Service believed that in so doing we seriously underestimated the magnitude of revenue losses that would occur across all mail classes if Congress removes the Statutes. The Service said that such losses could harm the Service's financial health and potentially undermine the historic postal reform legislation currently being considered by Congress. The Service said that it is difficult to forecast the Service's financial situation 5 or 10 years into the future and that using different assumptions produces different results.

We did not attempt to make long-range forecasts and predict future financial effects of changing the Statutes. Rather, our purpose was to show the sensitivity of the Service's revenue, costs, and postage rates to various "what if" assumptions about changes in mail volume by class and subclass.

Our principal method of examining these possible effects was to arrange with the Postal Rate Commission to use the same baseline data previously used by the Service and the Commission for estimating revenue, costs, and postage rates for planning and ratemaking purposes. At our request, the

Commission developed a broad range of estimated effects on the Service's revenue, costs, and postage rates, using various assumptions we provided about changes in mail volumes for letter mail classes and subclasses. It is important to note that all other assumptions and data used in examining these possible effects were those used by the Service and the Commission for establishing the postage rates that became effective in January 1995. As such, these possible effects are based on the Service's official volume, revenue, and cost estimates for 1 year (fiscal year 1995) that it presented to the Commission in March 1994.

To supplement the results of the Commission's work, we arranged for additional estimates to be provided by Price Waterhouse, using a financial model that it had developed for the Postal Service. This model included the Service's baseline estimates of such variables as mail volumes and revenue for 10 future years, 1996 to 2005. Using its model, Price Waterhouse showed how the Service's baseline estimates might change each year if the Service were to lose specified percentages of its letter mail volume in each letter mail class and subclass.

Thus, we did not attempt to predict what the Postal Service's financial condition would be in 5 or 10 years if the Private Express Statutes were removed or relaxed. Given the Postal Service's comments, however, we have further explained in our report the assumptions we identified for the analysis, how the estimates were derived, and how we intended for them to be used. We agree that as the Postal Service noted, other assumptions could lead to different results.

Additionally, the Postal Service expressed concern about how removing the Statutes might affect universal delivery service at uniform rates. The Service said that alternate delivery firms are interested in serving the most profitable areas and not expensive-to-serve areas. The Service also said that (1) the Statutes provide the financial underpinning for universal service, (2) removing the Statutes could unintentionally result in the end of universal and affordable mail service as the American people have known it, and (3) Congress should proceed "with great caution" when considering changes to the Statutes.

We agree that the Statues have provided the financial underpinning for universal service. We identified the longstanding public policy of providing universal mail service at uniform rates for some letter mail as one of several key issues Congress needs to consider in assessing the desirability of changing the Statutes. However, we also point out and discuss many other issues that are also relevant to postal reform. For example, the Service's net revenue and postage rates and, in turn, universal service could be affected by many factors—such as how Congress might change the Statutes, how the alternate delivery firms and other competitors might respond, what mail volume the Service might lose, and whether the Service can improve service quality and control operating costs.

In summary, it is unclear as to exactly how removing or relaxing the Statutes might affect private mail delivery. However, we believe that our report and the Service's comments provide Congress with much useful information for assessing the desirability of changing the Statutes, including assessing the changes proposed in the Postal Reform Act of 1996.

As agreed with the Subcommittee and unless you announce its contents sooner, we plan no further distribution of this report until 30 days from the date of this letter. At that time, we will send copies to the Postmaster General, to other Postal oversight committees in Congress, and to other interested parties. Copies will also be made available to others upon request.

The results of our review are presented in greater detail in volume II of this report. A list of major contributors is included in appendix IV of volume II.

If you or your staff have any questions about this report, please contact me on (202) 512-8387 or James T. Campbell, Assistant Director, on (202) 512-5972.

J. William Gadsby
Director, Government
Business Operations Issues

Comments From the U.S. Postal Service

See vol. II, app. II, for a copy of the Service's enclosure. Our evaluation of the enclosure is presented in vol. II, ch. 6.

MARVIN RUNYON
POSTMASTER GENERAL, CEO

UNITED STATES
POSTAL SERVICE

August 29, 1996

Mr. J. William Gadsby
Director, Government Business
Operations Issues
United States General Accounting Office
Washington, DC 20548-0001

Dear Mr. Gadsby:

Thank you for the opportunity to review and comment on the draft report entitled, Mail Service in the United States: Statutory Restrictions on Private Letter Delivery Are Being Questioned.

In this extensive study, your staff has done a credible job of presenting the requested information concerning the historical purpose and current applications of the laws and regulations known as the Private Express Statutes. However, when the study ventures into the area of speculating on the possible financial effects on the Postal Service of eliminating or substantially relaxing the Statutes, we think that the analysis and forecasts you present seriously underestimate the magnitude of revenue losses that would occur across all classes of mail if Congress were to remove the Statutes. Such losses would seriously harm the Postal Service's financial health and potentially undermine the historic postal reform legislation currently being considered by Congress.

We agree with the report's principal conclusion that it is impossible to predict with any reasonable degree of certainty what would happen to the Postal Service's financial condition if the Statutes were to be relaxed. We understand and appreciate the difficulty of GAO's task in trying to forecast our financial situation five or ten years into the future. As with any economic forecast, especially one with so many variables and uncertainties, the only absolute is that a change in the initial assumptions will produce a change in the results. The concerns we have with the study may be due in large measure to the assumptions built into it--assumptions that differ from those we routinely use in our forecasts. The enclosure discusses our concerns in more detail.

The report recognizes the alternate delivery industry as a potential source of competition. However, these businesses indicate both in words and actions that they are not interested in providing universal delivery service comparable to the Postal Service. Rather, they are only interested in delivering to those areas where they can do so most profitably. People living in rural or other expensive-to-serve areas would be, in effect, redlined.

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The Private Express Statutes provide the financial underpinning that allows the Postal Service to provide universal mail delivery at a uniform postage rate for letter mail. The unintended consequence of removing the Statutes may well mean the end of universal and affordable mail service as the American people have known it. We think Congress would be well advised to proceed with great caution in considering any undoing of the protections afforded the American people by the Statutes for over two centuries.

Best regards,

Marvin Runyon

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