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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

Preface

This volume of GAO's report presents a detailed analysis of the restrictions in federal, civil, and criminal law on private letter delivery, the Private Express Statutes. Volume I summarizes the results of GAO's review, including issues relevant to potential Postal Service reform and any future changes to the Statutes.

In chapter 1, GAO provides background information on the Postal Service's public service mission, the history and current provisions of the Statutes, and the recent congressional interest in reforming the Postal Service. Included are the objectives, scope, and methodology of GAO's review for this report. GAO focused primarily on the period from the Postal Reorganization Act of 1970 through 1995.

The four chapters that follow cover various aspects of restrictions on private letter delivery. These are

- the basis for the restrictions in law, economic theory, and current Postal Service policy and some of the Service's experiences in administering and enforcing the Statutes since 1970 (ch. 2);
- the growth and development of private message and package delivery capacity since 1970 (ch. 3);
- the risk of possible mail volume losses and estimates of the potential effects of such losses on the Service's revenue, costs, and rates (ch. 4); and
- the postal reform efforts of selected other countries, including changes to restrictions on private letter delivery (ch. 5)

Chapter 6 includes the Postal Service's technical comments on our report and our evaluation.

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.

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

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Business Operations Issues

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Abbreviations

AAPS	Association of Alternate Postal Systems
ACCA	Air Courier Conference of America
AMMA	Advertising Mail Marketing Association
APD	Alternate Postal Delivery
BSI	BellSouth Services, Inc.
CPI	Consumer Price Index
DMA	Direct Marketing Association
EC	European Community
ECI	Employment Cost Index
GSA	General Services Administration
NAA	Newspaper Association of America
NADA	Nationwide Alternate Delivery Alliance
NDS	National Delivery Service
PRC	Postal Rate Commission
PSO	public service obligations
REA	Railway Express Agency
RPS	Roadway Package System
TCMA	Third Class Mail Association
TMC	total market coverage
UPS	United Parcel Service
UPU	Universal Postal Union
USPS	United States Postal Service

Introduction

Despite restrictions in law and regulation on private letter delivery, the U.S. Postal Service faces increasing competition from private firms. Moreover, growing demands are being made to open even more of the Service's mail stream to competition. At the same time, some mail is reported to have been diverted to electronic communications, such as facsimiles and electronic mail. Although the Service's overall mail volume continues to grow, the Service is concerned that customers increasingly are turning to its competitors.

In light of this competition, the former Chairman of the Subcommittee on Federal Services, Post Office and Civil Service, and now Ranking Minority Member of the Subcommittee on Post Office and Civil Service, Senate Committee of Governmental Affairs, requested that we review aspects of the Private Express Statutes. To address his questions and related concerns, our objectives were to (1) determine the historical and current basis for restricting the private delivery of letters, including the Service's efforts to administer and enforce the restrictions; (2) document changes in private sector capacity for letter delivery since 1970, including specific letter mail services for which the Service competes; and (3) estimate the possible financial effects on how the Service's revenues, costs, and postage rates might change if current restrictions on private delivery of letters were to be changed. We also obtained information on whether selected other countries require the provision of universal mail service and if such countries restrict private letter delivery.

The Service's Primary Mission Is to Serve the Public

Although the Postal Service operates in an increasingly competitive environment, it is neither chartered nor empowered to function like its competitors. Rather, the Postal Reorganization Act of 1970 (the 1970 Act) and related legislative history show that the Postal Service is not expected to provide service to just those whose business is profitable to the Service, but to all Americans. When reporting on a bill to reorganize the former Post Office Department in 1970, a Senate oversight committee expressed its view of the principal role of what became the U.S. Postal Service as follows:

> ". . . the post office, however restructured, must be, first of all, responsive to the historic public need for, and reliance upon, a secure, swift, dependable, and inexpensive communications system." S. Rep. No. 912, 91st Cong., 2d Sess. 2 (1970).

The House committee reporting on the reorganization bill was more succinct, but just as emphatic:

"The Postal Service is—first, last and always—a public service." H.R. Rep. No. 1104, 91st Cong., 2d Sess. 19 (1970).

The legislative history of the 1970 Act shows that Congress also was concerned about balancing the Postal Service's public service mission with the expectation that postal managers would maintain and operate an efficient service. In the House Report quoted above, the Committee stated that "The Postal Service is a public service but there is no reason why it cannot be conducted in a business like way and every reason why it should be." H.R. Rep. No. 1104 at pp. 11-12. To this end, Congress removed the Service from the political arena by making it an independent establishment; giving sole power to a Board of Governors to appoint and remove the Postmaster General and his Deputy; and making the Postal Service exempt from many, but not all, laws that apply to federal agencies.

The U.S. Mail Monopoly: Its History and Current Provisions

For over 200 years, the Postal Service and its predecessors have operated with a statutory monopoly imposed by the Private Express Statutes, which restrict the private delivery of most letters. Over the years, Congress has reaffirmed the need for the monopoly many times. However, the scope of the monopoly has been both broadened and reduced at various times through statutory and regulatory changes.

The monopoly was created by Congress as a revenue protection measure for the Postal Service's predecessor to enable it to fulfill its mission. It is to prevent private competitors from engaging in an activity known as "cream-skimming," i.e., offering service on low-cost routes at prices below those of the Postal Service while leaving the Service with high-cost routes. Those who favor retention of the Statutes continue to cite the threat of cream-skimming as their principal economic justification.

The letter monopoly was not changed under the Postal Reorganization Act of 1970. Rather, Congress adopted then-existing restrictions on private letter delivery with little debate.

When it passed the 1970 Act, Congress directed the Board of Governors to evaluate the need to modernize the monopoly and report any recommendations to the president and Congress. In response, the Board recommended in its report ("Restrictions on the Private Carriage of Mail: A Report of the Board of Governors of the United States Postal Service," dated June 29, 1973) that the Statutes remain intact. But the Board recommended that the Postal Service suspend the Statutes by administrative action for certain items, including intracompany and data processing communications, as well as newspapers, periodicals, checks, and financial instruments that historically were deemed outside the definition of a letter. The Service adopted most of the Board's recommended suspensions by issuing regulations in 1974.

Restrictions on Private Letter Delivery Are in Criminal Statutes

The basic restrictions on private delivery of letter mail are in seven sections of the federal criminal statutes (18 U.S.C. 1693-1699). These Statutes generally prohibit anyone from establishing, operating, or using a private company to carry letters for compensation on regular trips or at stated periods over postal routes or between places where U.S. mail regularly is carried. Violators are subject to fines or, in some cases, imprisonment. The current maximum fines are $5,000 for individuals and $10,000 for organizations, and the maximum term of imprisonment is 6 months. The 1970 Act also contains provisions (39 U.S.C. 601-606) dealing with private delivery of letters.

Statutory Restrictions on Mailbox Access Provide Security and Further Protect the Service's Revenue

Along with the statutory restrictions on mail delivery, Congress passed a law in 1934 to restrict access to mailboxes (18 U.S.C. 1725). This law prohibits anyone from intentionally placing mailable matter without postage into any mailbox. The legislative history of the 1934 law shows the purposes of the mailbox restrictions were twofold. First, the law was designed to stop the loss of postal revenue resulting largely from public utilities using special messengers to deliver customer bills to mailboxes without paying postage. Second, Congress sought to decrease the quantity of extraneous matter being placed in mailboxes. Violators are subject to the maximum fines of $5,000 for individuals and $10,000 for organizations, but not imprisonment.

Postal Service Regulations Define a Letter

Congress did not define what constitutes a letter. Rather, the Service has issued regulations to define a letter for the purpose of administering the Statutes. These regulations define a letter broadly as "a message directed to a specific person or address, and recorded in or on a tangible object." (39 CFR 310.1 (a)) However, the regulations also exclude a number of items from that definition and suspend the Statutes for other letters, notably "extremely urgent," i.e., overnight, letters and outbound U.S. international letters.

Current Scope of the Monopoly

The Postal Service has six major classes of mail: First-Class, which consists mainly of correspondence (business and personal) and transactions, greeting cards, postcards, and some small packages; second-class, which includes newspapers and magazines; third-class, sometimes called "bulk business mail," which consists primarily of advertising matter and nonprofit fund solicitations; fourth-class, which includes parcels, library materials, and bound printed matter; Express Mail, which includes expedited, overnight letters and packages; and international mail, which includes all letters and packages mailed between the United States and other countries. The Service also maintains certain subclasses of mail, such as Priority Mail, which is heavier (more than 11 ounces) First-Class letters and packages.[1]

Under the current mail classification scheme, domestic letters subject to the Statutes fall primarily into First-Class (including Priority) and third-class mail. These classes and subclasses represented about 93 percent of the Service's total mail volume, which totaled over 180 billion pieces, in fiscal year 1995. These same classes and subclasses accounted for almost 91 percent of the Service's total 1995 mail revenue of $52.5 billion. According to the Postal Rate Commission, an estimated 83 percent of the Service's total mail volumes and about 82 percent of its revenues are protected under the Statutes.

In July 1996, as a result of a mail reclassification decision, the names of some mail classes used in this report changed. While current First-Class and Priority Mail designations remain the same, Express Mail changed to "Expedited," second-class to "Periodicals," and third-class and fourth-class to "Standard Mail."

Overall Reform of the Postal Service Recently Proposed and Debated

During 1995 and early 1996, both the Senate and House postal oversight subcommittees held several hearings in which they focused in part or in whole on the need for changes in the 1970 Act. A report issued in December 1995 by the House Committee on Government Reform and Oversight entitled "Voices for Change"[2] summarized the results of 10 hearings held by the Subcommittee on the Postal Service in 1995. Many witnesses at those hearings agreed that the Service faces challenges

[1]Primarily for market research purposes, the Service also has broken its mail stream into six "product lines," namely correspondence and transactions, advertising, expedited delivery, standard packages, publications, and international. A seventh product line, retail, involves nonmail services, such as money orders, post office box rentals, mailing supplies, and the like.

[2]H.R. Rep. No. 104, 104th Cong., 1st Sess., (1995).

because of new technology and competition in the overall communications environment. In the December 1995 report, four key issues that emerged during the oversight hearings were identified: the mail monopoly, labor-management relations, ratemaking, and new postal products. However, there was little consensus on specific solutions among the more than 36 witnesses who testified at the hearings. A final hearing on November 15, 1995, “The Postal Reorganization Act 25 Years Later: Time for Change?” set the stage for the Subcommittee’s 1996 agenda.

One legislative proposal (H.R. 210, 104th Cong., 1st Sess. (1995)) discussed during the House Subcommittee’s November 1995 hearing would turn the Postal Service over to its employees under an employee stock ownership program. This proposal provides for the continuation of the Private Express Statutes only during the first 5 years of the newly formed corporation’s existence. In a January 1996 hearing, the Senate and House postal oversight Subcommittees jointly continued to assess the need for Postal Service reform. At that time, the Subcommittees heard testimony on the postal reform experiences of some other countries. Representatives of postal administrations in four other countries (Australia, Canada, New Zealand, and Sweden) described major changes in those countries allowing the mail systems to operate with greater commercial freedom.

In June 1996, the Chairman of the Subcommittee on the Postal Service, House Committee on Reform and Oversight, introduced legislation (H.R. 3717) to reform the Postal Service. Under this bill, delivery of letter mail priced at less than $2.00 would be restricted to the Postal Service. According to the Subcommittee’s analysis, more than 80 percent of the Service’s letter mail volume would still be protected by law if H.R. 3717 as introduced is enacted.

Objectives, Scope, and Methodology

The former Chairman of the Subcommittee on Federal Services, Post Office and Civil Service, and now Ranking Minority Member of the Subcommittee on Post Office and Civil Service, Senate Committee on Governmental Affairs, requested that we review aspects of the Private Express Statutes. He requested the review after legislation (S. 1541, 103d Cong., 1st Sess. (1993)) was introduced in the 103rd Congress to curtail the Postal Service’s authority to enforce the Private Express Statutes.

Our objectives were to (1) determine the historical and current basis for restricting the private delivery of letters, including the Service’s efforts to administer and enforce the restrictions; (2) document changes in private sector capacity for letter delivery since 1970, including specific letter mail services for which it competes; and (3) estimate the possible financial effects on how the Service's revenues, costs, and postage rates might change if current restrictions on private delivery of letters were to be changed. Because of the Postal Service's interest—and, subsequently, House and Senate postal oversight Subcommittee interest—in how other countries had reformed their postal administrations, we obtained information on whether selected countries require universal mail service to be provided, as this country does, and if such countries restrict private letter delivery.

To review the Statutes' history, current basis, and enforcement, we (1) examined the legislative history of the Statutes and related laws from 1782 to 1995 and their implementation through Postal Service regulations; (2) interviewed Postal Service officials at headquarters and at Service field offices in California, Colorado, Florida, Georgia, Illinois, and Texas that we selected primarily because of their involvement in specific enforcement actions; and (3) reviewed relevant Postal Service data and reports. We also examined records summarizing Postal Inspection Service audits, completed from 1989 to 1994, of mailers' compliance with the Statutes. We interviewed representatives of selected companies in Georgia and Alabama that had been audited by the Inspection Service, including one whose experiences is related to proposed legislation (S. 1514, 103rd Congress) that served as the impetus for this review and another that the Inspection Service suggested because of the complexity of the case and the magnitude of the resulting settlement.

To document changes in private letter delivery capacity, we interviewed representatives of private delivery firms, major trade associations and mailer groups, knowledgeable industry observers, and Postal Service and other government officials; reviewed available literature; and analyzed relevant Postal Service and industry data. Specifically, we discussed private letter delivery activities with representatives of (1) each of the five major expedited mail and parcel delivery companies identified by the Postal Service as its principal competitors, at locations in the District of Columbia and in California, Pennsylvania, and Washington; (2) four national alternate delivery alliances located in Washington, DC, and in Georgia, Michigan, and New Jersey that were identified through a nationwide alternate delivery directory; (3) 15 alternate delivery firms located in California, Georgia, Michigan, Nevada, New Jersey, New York, Pennsylvania, Oklahoma, Texas, and Washington that were selected on a judgmental basis to ensure a broad range of geographic locations and population levels, large as well as small companies, and both independently and newspaper-owned firms; and (4) 25 trade associations and industry experts representing carriers as well as the majority of the Service's commercial and nonprofit customers located in the District of Columbia, New Jersey, New York, and Virginia.

To estimate the possible financial effects of changing the Statutes, we assessed such effects in the following two ways:

- First, we estimated the relative risk (high, medium, and low) of the Service's letter mail stream, by class and subclass, from direct competition by private delivery firms (as distinguished from electronic communications media).
- Second, we estimated the extent 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.

To assess the relative risk of direct competition, we used data obtained in our interviews, mentioned above, with representatives of the private delivery industry and mailer associations. We structured the interviews to obtain insight into the ability of private delivery firms to deliver letter mail now protected by the Statutes and the interest of mailers in using such firms. Along with these interview results, we compiled, but were unable to verify, various shipment data on private firms in order to estimate existing private delivery capacity and compare the magnitude of private mail delivery to that of the Postal Service.

To estimate the effects of mail volume losses on the Service's revenues, costs, and postage rates, we used estimated mail volumes and other data that the Postal Service and Postal Rate Commission used in a recent rate case (Docket No. R94-1). We assumed that for fiscal year 1995, the estimated number of First-Class, Priority Mail, and third-class mail pieces had been reduced in 5-percent increments from 5 to 25 percent. We used those percentages not to predict what would happen, but rather to show the potential effects on postal revenues, costs, and rates if the Service had lost these volumes of mail. We assumed that the financial effects of losing mail volumes would result in changes to postage rates, not reductions in the levels of service offered and not federal appropriations to offset revenue losses.

At our request and with the Service's approval, we also used a Price Waterhouse LLP model, developed under contract with the Service, to provide additional estimates for 10 future years of changes in the Service's revenues, costs, and rates as a result of assumed future mail volume losses. Additional details on the methods and assumptions used to estimate the effects of mail volume losses on the Service's revenues, costs, and rates are included in appendix I, volume II, of this report.

To obtain information on postal administrations in other countries, we reviewed several reports done by other U.S. organizations, including a February 1995 report prepared by Price Waterhouse for the Postal Service. We interviewed officials of several other postal administrations, visited the Canadian postal administration—Canada Post Corporation—in Ottawa, and reviewed annual reports and various other documents provided by foreign postal administrations. The information in this report concerning the postal laws of other countries does not reflect our independent analysis of those laws; rather, it rests primarily on the views and analysis provided to us by officials of those governments and other secondary sources.

We requested written comments on this report from the Postal Service and the Postal Rate Commission. The Postal Service responded by letter and an enclosure that presented its technical evaluation of the estimated financial effects of changing the Statutes discussed in our report. We have reprinted the letter and enclosure in appendix II, volume II. Our overall evaluation of the Service's comments is included in volume I, and we provide additional comments on the technical evaluation in chapter 6, volume II. The Commission chose not to provide written comments, but Commission officials suggested several changes to volumes I and II of our report to improve its technical accuracy and completeness, which we made where appropriate.

We also arranged for several knowledgeable parties, many of whom provided information for our report, to review and comment on our draft report, volumes I and II. We made changes as appropriate to the report on the basis of all comments we received. They were provided by Mr. Murray Comarow, Executive Director of the former Kappel Commission; and representatives of (1) Price Waterhouse LLP, (2) the Advertising Mail Marketing Association, (3) the National Association of Presort Mailers, (4) Federal Express, (5) United Parcel Service, and (6) Haldi Associates, Inc. (a consulting firm that has studied Postal Service mailing costs.)

Our review was conducted primarily between May 1994 and February 1996. It was performed in accordance with generally accepted government auditing standards.

Restrictions on Private Letter Delivery Protect the Service's Revenue Base but Are Increasingly Difficult to Administer

The Private Express Statutes play a fundamental role in determining how mail service is provided to the general public. However, compared to 1970, providing mail delivery as a public service today is far more difficult, and the Statutes have come to play a lesser role in protecting the Service's revenue. Some of the Service's largest customers and competitors have questioned the need for and the Service's enforcement of the Statutes. Responding to pressures to allow more private letter delivery, the Service suspended portions of the Statutes and has virtually stopped enforcing them.

Postal Service Believes Private Express Statutes Are Necessary to Protect the Service's Revenue Base

According to the legislative history and current Postal Service policy, the purpose of the Statutes has long been to ensure adequate revenue to permit the government to meet various public service objectives, including universal mail service to all communities. The Postal Service believes that any change in the Statutes could jeopardize its ability to meet such public service mandates.

The 1970 Act contains various public service objectives, such as (1) requiring uniformity of certain rates, (2) providing criteria for ensuring public access to services, (3) specifying how costs are to be allocated and postage rates are to be set, and (4) providing free or reduced rates to certain categories of mailers. As discussed below, these public services have changed over the years and differ in some cases from what was anticipated in 1970.

Postage Rates Are Less Uniform Today Than in 1970

The rate uniformity requirement, which is stated at 39 U.S.C. 3623(d), requires that the rates charged by the Service for at least one class of mail that is sealed against inspection must be uniform. The Service provides a uniform rate for First-Class letters delivered anywhere in the United States, its territories, and possessions. However, the Service's rates are more complex today than in 1970. The Service has adopted a broader range of rates over the years that more closely reflect its processing and delivery costs. To illustrate, in 1970, there were only two rates for 1-ounce First-Class letters—an 8-cent rate for regular letters and an 11-cent rate for air mail. For third-class mail, there were three rates—23 cents per pound for circulars and 17 cents per pound for books, with a minimum rate per piece of 4 cents. No discounts were offered to mailers who presorted their mail or performed other steps that reduced the Service's processing time and costs.

In contrast to the 1970 rates, current postage rates, which became effective in January 1995, include a variety of First-Class and third-class rates. The single-piece, 1-ounce First-Class letter is 32 cents. First-Class mailers who perform certain worksharing functions that reduce the Service's processing costs are charged lower rates. The eight worksharing rates for First-Class letters weighing 1 ounce or less range from 25.4 cents to 30.5 cents.[3]

Similarly, the rates for letter-size third-class mail are different today from what they were in 1970. Currently, such rates vary depending on the extent of transportation and preparation (i.e., presorting and prebarcoding) by mailers and the weight of the piece. For example, the rates for one piece of regular, bulk, third-class letter-size mail with no mailer transportation or preparation is 22.6 cents but reduced to 11.7 cents if the mailer presorts it into the order that it is to be delivered and transported to the postal unit responsible for delivery.[4]

Further, the volume of First-Class mail subject to the uniform rate requirement has declined, as a percentage of total mail volume, since 1971. In 1971, First-Class mail made up 59.2 percent of the total volume, compared to 53.3 percent in 1995. In contrast, third-class mail increased from 23.6 percent of the total volume in 1971 to 39.3 percent in 1995.

Currently, a relatively small percentage of the overall mail volume is generated by residential customers. In 1994, according to the Service's studies, the volume of household-generated mail represented 10 percent of the total volume; the volume of household-to-household mail was an even smaller part—only 3.6 percent of the total. About 55 percent of the total mail stream was sent from business to households, and about 35 percent was sent from business to business. The Postal Service did not have similar data for 1970 or other years immediately following the 1970 Act on business and residential mail volumes.

[3]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.

[4]This is a bulk regular rate (meaning several hundred pieces are given to the Postal Service in a single mailing) for letter-size third-class mail pieces, each weighing 3.3071 ounces or less, and sequenced by the mailer down to the carrier route to allow a particular geographic area to be "saturated" with third-class mail.

Access to Mail Services Provided Primarily Through Post Offices

Under the 1970 Act, the Service must provide access to the U.S. mail system through post offices and other means. However, the Service may not close a post office solely because it is operating at a deficit, even though a more cost-effective means of providing access may be available. Rather, under the 1970 Act, a number of criteria must be considered.[5] Further, any person whose service is affected by any proposed post office closing may appeal the closing to the Postal Rate Commission (PRC).

Postal Service officials told us that the number of post offices not producing sufficient revenue to cover the related operating costs has grown since 1970. This trend has occurred for three basic reasons. First, the make-up of mail has changed, with far more business mail and far less residential mail. Secondly, worksharing postage rates introduced since 1970 encourage mailers to (1) bypass local post offices and "drop ship" mail closer to the mail's delivery destination; and (2) deposit large volumes of mail, already sorted and barcoded, at the Service's mail processing plants rather than local post offices. Thirdly, in earlier years, postage stamps could be purchased only from a post office or rural letter carrier. Today, they may be obtained from a variety of sources, including grocery and other retail stores, vending machines, and mail carriers. Stamps may also be ordered by mail.

The Service is exploring various ways, in addition to the traditional post office, of providing ready customer access to all "retail" postal services, such as placing "Postal Express" units in private retail stores located in shopping centers and opening postal stations in shopping malls.

The Service is constrained, however, in upgrading its post office infrastructure, which remains largely the same as in 1970. According to Service data, of the 39,149[6] 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. Under the 1970 Act, as amended in 1976, the Service is required to follow specific procedures and criteria for closing post offices. These procedures include responding to appeals that could be filed by any person whose service may be affected by the proposed post office closing.

[5]Section 404 of Title 39 states that any decision to close a post office must consider certain specific criteria, including (1) the effect on the community served, (2) the effect on employees of the post office, (3) compliance with the government policy that the Service shall provide a maximum degree of effective and regular postal services to areas where post offices are not self-sustaining, (4) the economic savings to the Service, and (5) any other factors determined to be necessary by the Service.

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

Under the 1970 Act, the Commission has 120 days to make a decision on each such appeal. Of the 239 proposed post office closings in fiscal year 1995, 22 were appealed to the Commission. Fourteen closings were upheld, 4 appeals were withdrawn, and 4 were sent back to the Service for further review, i.e., remanded. According to Commission data, the time necessary to complete the appeals process was less than 120 days in each of the 22 cases. In some cases, however, the total time taken to close a small post office ranged up to several years from the date the Service began working with the affected community to the date of the closing. For example, in consolidating a post office in Clarkia, Idaho, the Service began the process in October 1993, and PRC issued a final document on the case stating that the Service met statutory requirements in March 1996—about 30 months later.[7]

All Domestic Postage Rate Changes Are Subject to Regulatory Review

In line with its public service mission and restrictions on private letter delivery in the 1970 Act, the Service and PRC must allow the public, including competitors, to review and comment on proposed changes to domestic postage rates and mail classifications. Changes to international mail rates are not subject to review outside the Postal Service.

The 1970 Act includes specific criteria and requirements for allocating costs among classes of mail and for achieving various public service objectives. Achieving those objectives, while also recognizing the impact of the competitive markets in which the Service must operate, involves some trade-offs. For example, in setting rates under the 1970 Act, the Service and PRC must balance a number of criteria, including the relative demand for the various classes of mail and the need to be fair and equitable to all its customers. Achieving this balance has generated much debate and disagreement among the Service, PRC, and many parties who participate in ratemaking or are affected by the resulting rates.[8]

[7]Most of this time (about 17 months) elapsed from the point when the Service first polled the community to obtain views on the proposed Clarkia post office consolidation until a member of the Clarkia community appealed the planned action to the Commission. The Commission initially remanded the proposed closing to the Service and later affirmed the Service's decision to consolidate the post office. These two actions took less than 120 days each.

[8]For a more detailed discussion of policies, criteria, and issues surrounding postal ratemaking, see: U.S. Postal Service: Pricing Postal Services in a Competitive Environment (GAO/GGD-92-49, Mar. 1992); and U.S. Postal Service: Postal Ratemaking in Need of Change (GAO/GGD-96-8, Nov. 1995).

Collective Bargaining Follows a Process Unique to the Postal Service

The Service must follow some procedures and criteria prescribed in the 1970 Act for bargaining with unions and resolving disputes over working conditions, including employee pay and benefits, that are unique to the Service. Unlike other federal and private organizations, the Service is also required by law to consult with postmasters and supervisors before making any changes to pay and certain other matters affecting these employees. Postal Service employees do not have the right to strike, nor does postal management have the right to lock out striking employees or hire replacements. Instead, the 1970 Act provides for binding arbitration to resolve bargaining deadlocks.

When adopting this provision in 1970, Congress emphasized that the parties were to make every attempt to reach agreement bilaterally through earnest, good faith negotiations. Arbitration was to be used only as a last resort. However, contract negotiations between postal management and most of the major unions often have resulted in impasses that were settled by an arbitrator.[9]

Private Express Statutes Are Believed Necessary to Meet Public Service Obligations With Current Statutory Constraints

The Postal Service believes that the Statutes must remain intact if it is to carry out its current public service mission in accordance with the various requirements and constraints of the 1970 Act, some of which we discussed previously. No private sector organization that competes with the Service has similar requirements or constraints.

The Service believes, for example, that its "double postage rule"[10] for private delivery of extremely urgent letters is necessary to maintain adequate revenue for operation of the current system. This rule can result in additional cost to some mailers who choose to use private carriers for nonurgent mail delivery and, in turn, agree to pay required postage to the Service, under "alternative postage agreements," which we discuss later in this chapter. The rule also sets a minimum price that any customer of a private delivery firm must pay for certain letters.

The Service believes that the protection provided under the double postage rule is necessary for meeting its public service obligations. For example, the Postmaster General, as part of his testimony in 1995 before

[9]For additional information on the Service's bargaining experience, see our report U.S. Postal Service: Labor-Management Problems Persist on the Workroom Floor (GAO/GGD-94-201A and 201B, Sept. 29, 1994).

[10]This rule allows for the private delivery of a letter under the presumption that if a customer is willing to pay twice the applicable First-Class rate, including Priority Mail, or $3.00, whichever is greater, the letter must be extremely urgent.

the Subcommittee on the Postal Service, House Committee on Government Reform and Oversight, said that "If the double postage rule for extremely urgent letter mail was suspended, all Postal Service letter and flat [a larger size envelope] mail potentially could be diverted." He said that eliminating the rule would jeopardize the Service's mandate to provide universal service at uniform rates because private carriers would resort to "cream skimming." These practices were described in the Board of Governors' 1973 report on the Statutes and are discussed more fully below.

Mailers and Competitors Have Challenged the Administration and Enforcement of the Statutes

While the Service views the Private Express Statutes as essential to executing its public service mission, the administration and enforcement of the Statutes have been challenged by mailers and competitors. These challenges have come in the form of questions regarding the underlying economic theory cited by the Board of Governors in 1973 for the Statutes and requests for the Service to suspend the Statutes for certain letter mail. Responding to pressures from mailers and competitors, the Service suspended the operation of the Statutes for certain letters in 1979 and 1986, only to have its authority to make such suspensions questioned by competitors and other parties. Moreover, Postal Inspection Service officials told us they have stopped direct enforcement of the Statutes because of pressures from mailers, competitors, and some Members of Congress.

Premise That a Single Provider Results in Lowest Overall Cost to the Public Challenged

The restrictions on private delivery contained in the Statutes have been defended by a number of parties, including the Kappel Commission,[11] the Board of Governors in its 1973 recommendation to Congress,[12] 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 providers.

[11]President Lyndon Johnson appointed the President's 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).

[12]Stated differently, the Board concluded that the Postal Service was a "natural monopoly" because important savings to customers result from having a single supplier of mail service. According to the Board, these savings were due to economies of scale, wherein increasing volumes result in a lower unit cost for each additional piece of mail processed.

- Without restrictions on private delivery, cream-skimming by private competitors in the most profitable postal markets would undermine the ability of the Service to provide universal service at reasonable, uniform rates.
- Postal services, historically, have been viewed to be of such importance 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.

Whether the Postal Service does or can achieve these objectives more effectively than if additional providers are allowed to participate freely in letter mail delivery has been studied and debated often since the Board's 1973 report. Some of the Service's largest customers and competitors, PRC, the Department of Justice, and many economists have questioned the need for and economic justifications of the Statutes in today's environment. A complete analysis of all economic perspectives on the Statutes was not within the scope of our review. However, we did examine two proposals for changing the Statutes made by some of the Service's largest third-class customers. The proposals and the Service's responses, discussed below, were predicated on discussions of economic theory concerning the letter mail monopoly published since the Board of Governors' 1973 report.

Third-Class Mailers Have Questioned the Economic Basis Cited for the Statutes

Some of the Service's largest customers requested that the Service take steps to allow certain letters to be delivered by private carriers. Primarily because of concern for maintaining its revenue base, the Service declined to allow such delivery.

In March 1988, the Third Class Mail Association (TCMA), a trade association representing more than 300 companies and other organizations engaged in "distributed" advertising, requested that the Postal Service suspend the Statutes for third-class mail. TCMA, which is now the Advertising Mail Marketing Association, believed that the suspension would serve the public interest because the Service's definition of a letter was not equitable. For example, advertisers who mailed catalogs of 24 pages or more could use private carriers, but those whose catalogs were under 24 pages could not. TCMA also argued that the advertising industry did not receive benefits from the Service that were commensurate with the rates charged, and it should be allowed to use alternative delivery services. Finally, TCMA was concerned that the advertising industry would bear an even heavier share of the Service's cost in the future because of attempts to "balance" the perceived value of advertising mail with other mail, such as business and personal communication.

The Postmaster General responded that the requested suspension would not be in the public interest. The Service's principal argument against the suspension was that third-class mail, which ranked second to First-Class in revenue and volume, was too important to the Postal Service as a whole. The Service also pointed out that certain items, such as books, were already excluded from the Statutes. The Service also disagreed with TCMA's view that third-class mail had been assigned overhead costs disproportionately in comparison to other classes. Finally, the Service emphasized that all of the mail it delivers is valuable and expressed concern about the public's perception regarding the nature of third-class mail, which is sometimes referred to by the general public as "junk mail," and its contribution to the Service's financial well-being.

In October 1988, TCMA submitted a complaint to the Commission to compel the Postal Service to suspend the Statutes (under authority in 39 U.S.C. 601) for addressed, third-class mail. The complaint did not result in suspension. However, PRC requested a written compilation of theoretical views[13] regarding economic justifications for the monopoly. PRC held hearings and published its proceedings but did not reach any conclusions or take any action on the complaint or the related views it received. At the same time, PRC reported that relevant economic theory had advanced since 1970. It said, "New cost and pricing concepts have been developed that can provide theoretical insights into both justifications for, and challenges to, a statutory monopoly." Since the PRC monopoly inquiry, a number of papers, articles, and books have been published concerning the economic reasons for and against the postal monopoly.

Unresolved Issue of Whether Mail Delivery Is a Natural Monopoly

Debates about the economic justification for the Statutes often focus on whether postal functions fit the economic model of a natural monopoly. One argument is that among the various postal functions, namely, collection, sorting, transportation, and delivery, those that most closely resemble a natural monopoly are collection and delivery. Generally, this is because the economies of scale and scope associated with such functions are believed to favor economic and efficient provision by a single supplier. In this regard, postal services frequently have been compared to telecommunications services. Until passage of the Telecommunications Act of 1996, local telephone companies maintained networks for call

[13]Monopoly Theory Inquiry, Docket No. RM89-4, Postal Rate Commission, November 1989.

origination and termination that have been compared to postal collection and delivery functions. Long-distance carriers provided services that more closely resembled postal sorting and transportation functions, the intermediate steps that occur between pickup and delivery.[14]

Various competing economic theories, and their relationship to current statutory restrictions on postal services, have been offered and debated. Some maintain that the provision of the most efficient, universal, and affordable postal services requires maintenance of the postal monopoly. Others argue that postal customers will be best served only under free and open competition. Our research of literature on the issue (see selected bibliography) revealed that none of the materials that we reviewed indicated a need to expand the scope of the Statutes—a conclusion also reached by the Board of Governors in 1973. The vast majority of the research results and opinions that we reviewed indicated that (1) economic theory supporting the Statues has changed since they were last reviewed in 1973, and (2) much more is known today about the Service's operating costs than in earlier years.

For example, in testimony before Congress in 1995, a United Parcel Service (UPS) representative presented a paper prepared by two economists in which they challenged the economic basis for the Statutes. The authors of that paper, subsequently published in book form,[15] asserted that there appeared to be "no intellectually defensible argument that the Postal Service's statutory monopoly under the Private Express Statutes flows directly from a natural monopoly that it purports to possess over mail delivery." Instead, they said that private firms had proven mail markets to be "demonstrably competitive" and called for repeal of the Statutes in order to "encourage the entry of private firms into mail services currently monopolized by the federal government." The authors also concluded that universal service and geographic uniformity of rates no longer depended on "public provision of the full range of postal services." Rather, they argued that competitive provision of letter mail service not only would ensure universal service, but likely would "increase . . . the integrity and efficiency of the mail stream because of the superior incentive structures . . . in private firms."

[14]For example, see: (1) Crew, Michael A. and Paul R. Kleindorfer, The Economics of Postal Service (Boston: Kluwer Academic Publishers, 1992); (2) Adie, Douglas K., Monopoly Mail (New Brunswick, NJ: Transaction Publishers, 1989); and (3) Panzar, John C., "Competition, Efficiency, and the Vertical Structure of Postal Services," in Regulation and the Nature of Postal and Delivery Services, eds. Michael A. Crew and Paul R. Kleindorfer (Boston: Kluwer Academic Publishers, 1993).

[15]See Sidak, J. Gregory and Daniel F. Spulber, Protecting Competition from the Postal Monopoly (Washington, DC: American Enterprise Institute, September 1995).

Relaxation of Third-Class Monopoly Proposed by Mailers and Carriers in 1995

In January 1995, a group of the Service's customers and competitors called the Coalition for the Relaxation of the Private Express Statutes[16] petitioned the Postal Service to initiate a rulemaking to suspend the Statutes for all or certain categories of third-class mail. The Coalition said its members included "private carriers of mail that would like to be able to compete more broadly with the USPS and users of USPS third-class mail that would like the opportunity to enjoy the benefits of such competition." Coalition participants included the nation's largest alternate delivery networks and the industry's recognized trade association, as well as the largest third-class mailers' associations. In other words, the Coalition acted on behalf of organizations representing the vast majority of those who mail third-class material and who deliver it outside the U.S. mail system.

In its petition, the Coalition said that the world had changed markedly since the Service examined the Statutes in 1973. For example, the Coalition cited such changes as (1) the Service's "de facto relaxation of its monopoly over the transportation of mail;" (2) increased competition in the telecommunications industry, which had been used as a public service monopoly model to justify continuing the letter mail monopoly; (3) better understanding of the Service's mail delivery costs and the consequences of mail volume and revenue losses; and (4) changes in economic thinking regarding the application of natural monopoly theory to postal services.

In response to the Coalition's petition, the Service's General Counsel declined to initiate the requested rulemaking procedure. She said that for the most part, the developments discussed in the petition predated the 1988 request discussed above. She also argued that to consider the issues raised by the Coalition "in a piecemeal fashion" by focusing only on private express matters and one particular class of mail would not allow the Service to address broader issues, such as infrastructure and labor costs and pricing.

Currently, private delivery of addressed, third-class letter mail is prohibited under the Statutes and implementing Postal Service regulations. According to the Service's mail stream breakouts, the vast majority of third-class mail meets its definition of a letter. Third-class mail represented 71.1 billion pieces, or nearly 40 percent of the Service's total

[16]The Coalition was organized by the president of Alternate Postal Delivery, Inc., headquartered in Grand Rapids, Michigan. Other principal Coalition firms included the Advertising Mail Marketing Association and the Direct Marketing Association. Publishers Express in Marietta, Georgia, (which later discontinued operations) and the Association of Alternate Postal Systems also participated.

mail volume, and $11.8 billion, or almost 23 percent, of its total revenues in fiscal year 1995.

Service's Suspension of Statutes for Certain Letters Questioned

As a result of requests made primarily by private delivery companies, the Service has issued regulations to suspend the Statutes for certain letters. Included in the suspensions are extremely urgent letters and international letters originating in the United States for delivery in other countries. However, some parties have questioned the Service's authority to make such suspensions.

In 1979, the Postal Service suspended the Statutes for extremely urgent letters (39 C.F.R. 320.6). The 1979 suspension allows letters to be sent by private carrier without payment of postage if the letters are deemed extremely urgent. The regulations specify criteria that must be met for a letter to qualify as extremely urgent. Relying on that suspension, some private companies began a practice called "international remailing" wherein nonurgent letters mailed in this country were transported by private carriers to other countries for distribution and delivery to other countries. For several years afterwards, the Service tried to stop international remailing. Believing this practice was a misuse of the urgent-letter suspension, the Service proposed to modify the 1979 suspension to clarify that it did not allow for international remailing. However, U.S. mailers' comments on the proposed clarification were overwhelmingly negative. Because of requests from mailers and private carriers to continue the practice, the Service issued regulations in 1986 to exempt all outbound international letters from the Statutes.[17]

To suspend the Statutes, the Postal Service cited a provision of the 1970 Act that (1) set forth certain circumstances in which private delivery of letters is permitted (39 U.S.C. 601(a))[18] and (2) allows the Postal Service to "suspend the operation of any part of this section upon any mail route where the public interest requires the suspension" (39 U.S.C. 601(b)).

[17]For additional information on the Service's role in international mail markets and related competitive issues, see U.S. Postal Service: Unresolved Issues in the International Mail Market (GAO/GGD-96-51, March 1996).

[18]Specifically, section 601 (a) of the 1970 Act says that a letter can be carried out of the mail when (1) it is enclosed in an envelope; (2) the amount of postage that would have been charged on the letter if it had been sent by mail is paid by stamps, or postage meter stamps, on the envelope; (3) the envelope is properly addressed; (4) the envelope is so sealed that the letter cannot be taken from it without defacing the envelope; (5) any stamps on the envelope are canceled in ink by the sender; and (6) the date of the letter's transmission or receipt by the carrier is endorsed on the envelope in ink.

Some parties in both government and the private sector have questioned whether Congress intended that the latter provision (601(b)) be used to permit greater use of private carriers to deliver letter mail. They have argued that the purpose of 39 U.S.C. 601(b) was to provide authority to the Postal Service to stop, not facilitate, private delivery of letter mail.

In 1973, when the Postal Service proposed regulations to suspend the Statutes for certain items, PRC's legal staff reviewed the regulations and concluded that use of the suspension authority would violate the original legislative intent to stop private carriage of letters. In 1976, after the regulations were adopted, PRC decided that it did not have jurisdiction over the Service's proposed changes to the Statutes and therefore elected not to comment further on the proposed rulemaking.

Subsequently, the Service proposed to suspend the Statutes for extremely urgent letters in 1979 after representatives of the private delivery companies urged Congress to exclude such letters from the Statutes. Industry representatives, including ACCA, also contended that the Postal Service's use of the suspension authority in 39 U.S.C. 601(b) violated its legislative intent. They were concerned that if the Service could unilaterally suspend the Statutes, it could similarly revoke the suspension, and they contended that this would create havoc for the existing private delivery companies and jeopardize their financial stability. They said the industry had not taken the issue to court because resolving the matter through litigation likely would be expensive and protracted.

In 1988, the President's Commission on Privatization reported that ". . . there is a legal issue as to whether the Postal Service has the authority to issue regulations (as in 39 C.F.R., Part 320 above) suspending the criminal code. If it does not, then all the private express couriers are in violation of criminal law under Title 18."

A Postal Service official told us that the language of the Statutes is broad enough to cover suspensions intended either to stop existing private delivery of letters or to allow additional private delivery. In addition, the Postal Service believes that Congress concurred in the Service's interpretation of the Statutes and use of the suspension authority when Congress was reviewing the proposed suspension for extremely urgent letters during hearings held in 1979.

Enforcing the Statutes Has Become Difficult

Despite criminal sanctions for violations, Postal Inspection Service officials told us that direct enforcement of the Statutes rarely occurs and has proven difficult for a number of reasons. They include past objections to enforcement by mailers, competitors, and some Members of Congress. Consequently, compliance with the laws and regulations is largely voluntary.

Enforcing the Statutes is difficult because violations can occur at any household or business in the United States where letters originate. The difficulty of enforcing the Statutes is compounded by statutory exceptions and regulatory suspensions that permit private delivery of some letters, but not others. For example, under the suspension for extremely urgent letters, mailers determine whether their letters meet the urgency criteria. Consequently, nonurgent letters may also be mailed privately without any easy means of detection.

Further, when the Service tries to enforce the Statutes, it finds itself in an adversarial, and possibly self-defeating, position of investigating and prosecuting its own customers. Separately, private carriers told us that they do not examine the contents of sealed envelopes and packages tendered by their customers for overnight delivery. Rather, they suggested that primary responsibility for compliance with the Statutes rests with mailers, not carriers. However, carriers also bear certain responsibilities under Service regulations.[19]

Postal Inspection Service data show that the Inspection Service completed compliance audits and follow-ups[20] at 62 business and government entities between October 1988 and June 1994. Of these 62 entities, 39 (63 percent) had violated the Statutes, according to the Inspection Service. None were prosecuted, nor were any fines or penalties assessed.

Of those 39 entities, 22 said they had stopped sending nonurgent letters via private carriers. Another 13 chose to continue using private carriers to deliver nonurgent letters and, through March 1995, had paid the Service about $1.2 million under "alternate postage agreements."[21] Of the $1.2 million, about $989,000 (81 percent) was paid by one company. Our review of the Inspection Service audit reports showed that mailers

[19]Service regulations (39 C.F.R. 310.4) state that private carriers should take reasonable measures to inform customers of their obligations under the regulations and should not carry any matter that may reasonably be determined to be unlawful for private carriage.

[20]According to the Inspection Service, most follow-up visits to mailers did not include additional audit work but were done to administer ongoing alternate postage agreements.

[21]Alternate postage agreements between the Service and mailers or private carriers are used in lieu of requiring actual postage affixed to letters sent privately.

generally wanted to use private carriers because they charged lower rates and provided more dependable delivery services than the Postal Service. Two examples follow.

BellSouth

BellSouth Services, Inc.(BSI), in Birmingham, Alabama, is an affiliate of BellSouth Corporation, headquartered in Atlanta. BSI provides mailing and other services for BellSouth's regional telephone companies—Southern Bell and South Central Bell. BSI initiated a cost-cutting move in the mid 1980s, whereby Southern Bell stopped using its own employees to carry intracompany mail. Instead, it began using a trucking service, already under contract to transport supplies, to also carry the mail at no additional cost.

On their own initiative, BellSouth corporate officials determined that this arrangement was in violation of the Statutes and that postage should have been paid for letters sent by contract carrier. In August 1989, Southern Bell's Jacksonville, Florida, unit found that it owed about $5,300 in postage for that month and paid that amount to the local postmaster. Subsequently, the Postal Inspection Service initiated an audit at the Jacksonville unit in September 1989 and determined that the postage due from BellSouth on letters sent to and from Jacksonville by the contract trucking service amounted to over $69,000 per year. BSI officials elected to continue using the trucking service and signed an alternate postage agreement to pay the Service for ongoing postage.

BellSouth officials in Atlanta asked the Inspection Service to audit other Southern Bell and South Central Bell operating units, and it found violations at all but one unit. In total, postal inspectors conducted 23 audits, including follow-up visits, at BellSouth units between fiscal years 1990 and 1994. As of March 1995, the Inspection Service reported total collections of about $989,000 from BSI under various alternate postage agreements.

BellSouth officials told us that the arrangement with the Postal Service was satisfactory to them because they were still saving postage costs. However, company officials also indicated they did not like having to pay the Postal Service for services it was not providing.

Equifax, Inc.

Equifax, Inc., a credit reporting company in Atlanta, was audited by the Inspection Service on the basis of a March 1991 lead from a Postal Service employee. Equifax initially denied the Inspection Service access to company mailing records. However, after the Inspection Service submitted a written request to the company's president, Equifax agreed to cooperate. In order to determine the amount of postage due to the Postal Service, the Inspection Service analyzed mail sent by the company's primary private carrier between June 1991 and March 1992 and conducted a 2-week survey of mail sent by a secondary private carrier.

The Inspection Service reported that Equifax used private carriers to deliver nonurgent letters without required postage, thereby violating Service regulations. While the private carriers offered lower rates than the Postal Service for some, but not all, zones, Equifax's decision to use private carriers appeared to be based primarily on service rather than cost considerations. Consequently, Equifax signed an alternate postage agreement for the 1-year period that ended in September 1992 and agreed to pay $32,682 on letters sent by private carriers. Equifax and the Postal Service did not continue the agreement beyond that year because Equifax said that it had changed its policy on the use of private carriers. The Inspection Service did follow-up work in September 1993, determined that Equifax was in compliance, and closed the case.

Equifax officials told us that they viewed the audit experience as "counterproductive." The audit resulted in payments to the Postal Service totaling less than $33,000, compared with total postage expenses of about $8 million that officials said the company pays annually.

Compliance Audits Discontinued

In 1993 and 1994, mailers and competitors questioned the Service's authority to audit mailers' compliance with the Statutes and to collect postage on letters sent by private carriers. By June 1994, the Postmaster General had deemphasized the Postal Inspection Service role in ensuring compliance with the Statutes by shifting that responsibility from the Chief Postal Inspector to the Senior Vice President for Marketing. This change was made after concerns were raised in Congress regarding the Service's audits of various mailers. A bill (S. 1541, 103d Cong., 1st Sess. (1993))[22] was introduced in October 1993 to limit the Service's authority to fine or otherwise penalize mailers who used private carriers. The Inspection Service has not initiated any new compliance audits since February 1994.

Currently, the Postal Service tries to promote compliance by educating mailers and private carriers about the Statutes. It believes that the Statutes act as a deterrent to illegal delivery of letters by private carriers. The education efforts include the use of postmasters and other postal

[22]This bill was not enacted.

employees to apprise the public of the Statutes' requirements and discussions by Service officials at various symposia and conferences attended by mailers.

In 1994, the Service established an office in Chicago with primary responsibility for educational efforts regarding the Statutes. The office, which had two employees, reviews allegations of possible violations of the Statutes coming into the Postal Service. When warranted, the office can forward apparent violations to the Postal Service's General Counsel and request audit support from the Postal Inspection Service. Examples of educational activities conducted by the Chicago office included participation in several national and regional conferences with postal customers, presentations on the Statutes to postal employees at various locations around the country, coordination with Postal Service account managers assigned to work with major commercial mailers, administration of existing alternate postage agreements, and conduct of compliance reviews at mailers' facilities.

Private Mail Delivery Capacity Has Grown Substantially Since 1971

In 1971, the Postal Service faced little competition for delivery of letter mail. Its competition has grown substantially since that time, partly as a result of the Service's regulatory suspension of the Private Express Statutes for certain letters. Although the bulk of the Service's mail volumes has remained under the protection of the Statutes, numerous national and local mail delivery firms exist; both their numbers and the volume and variety of services they offer are increasing.

Generally, private delivery firms that we reviewed delivered (1) expedited (or overnight) and 2-day and 3-day (also called deferred) letters and parcels or (2) unaddressed advertising circulars or periodicals. These firms compete on a local, national, or international basis for portions of delivery markets previously served largely or exclusively by the Postal Service.

Few Private Mail Carriers Existed in 1971

In 1971, the newly organized Postal Service faced limited competition from two private carriers, the Railway Express Agency (REA) and United Parcel Service (UPS). This competition was largely confined to the surface delivery of packages, although UPS did offer a limited, second-day air package service beginning in 1971. REA never posed a strong competitive threat to the Postal Service. Its business had dropped off steadily since the late 1940s and, in 1975, REA filed for bankruptcy and terminated all operations.

Although UPS was a growing business, it trailed well behind the Postal Service. In 1971, UPS' surface deliveries totaled about 547 million packages. By comparison, the Postal Service delivered approximately 968 million pieces of fourth-class mail in 1971.[23] The Postal Service held an even greater edge in second-day air services, delivering about 197 million Priority Mail pieces in 1971, compared to 11 million second-day UPS air shipments.

In 1971, when the Postal Service introduced an experimental Express Mail service, Federal Express (FedEx) was not yet operating. FedEx began overnight delivery operations in April 1973. FedEx discloses limited information on its delivery volumes but did report handling an average of

[23]Comparisons between Postal Service fourth-class mail pieces and UPS ground parcels should be considered only as an indicator, not a precise measure of respective market shares. We were unable to make exact comparisons between Postal Service and UPS parcel volumes primarily because the Service delivers an undetermined number of small packages as First-Class and third-class mail. These packages generally weigh less than 1 pound and contain items such as prescription drugs or film and photographs.

35,000 packages per night at its Memphis, TN, hub in 1978. If FedEx maintained this rate for 250 business days, its package volume would have totaled nearly 8.8 million pieces in 1978. During that same year, the Postal Service delivered approximately 8 million Express Mail pieces. Thus, on the basis of these data, it appears that FedEx may have surpassed the Postal Service as the leading overnight delivery carrier in less than 5 years.

The limited competitive environment of the early 1970s was indicated in a study of the Statutes mandated by Congress in the 1970 Act and conducted by the Postal Service's Board of Governors in 1973. In that study, a Postal Service contractor, McKinsey & Company, was to review the threat of private sector delivery to First-Class (letter) mail. However, to conduct the study, McKinsey had to construct two hypothetical firms because it found that "no comparable real ventures" existed.

Private Carriers Dominate Expedited Mail and Parcel Markets and Increasingly Are Offering Deferred Delivery Services

In 1992,[24] a small number of large, private carriers dominated the expedited letter and package delivery markets. The Postal Service competes for business in those markets through its Express Mail and parcel post services, respectively. Most of those private carriers also have made substantial gains in the deferred delivery market by offering 2-day as well as 3-day air shipments in competition with the Service's Priority Mail.

Several Large National Expedited Delivery Firms Compete Aggressively With the Postal Service

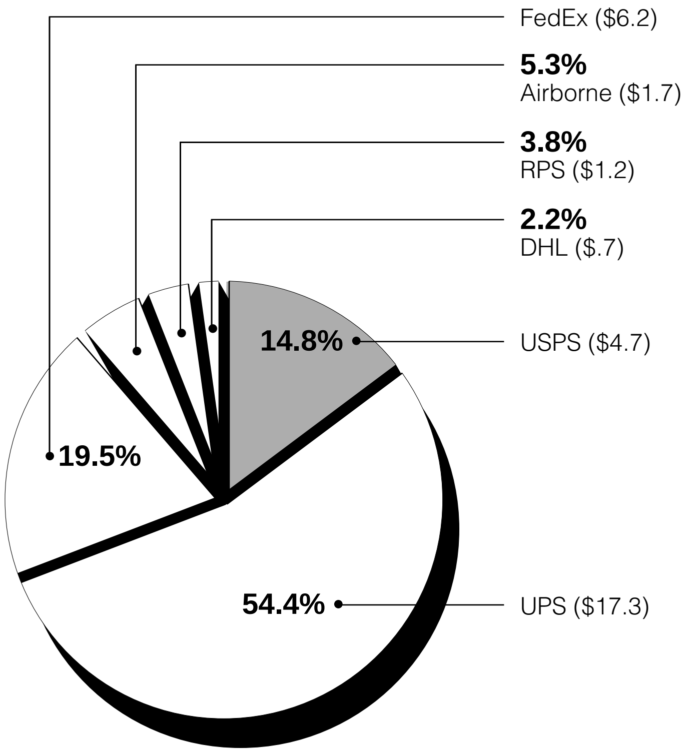
After the Postal Service suspended the Statutes for delivery of extremely urgent letters in 1979, several private carriers joined the Postal Service, UPS, and FedEx in the expedited letter and package delivery markets. In 1979, Airborne Freight Corporation, a Seattle-based company, began offering expedited letter and package deliveries through its subsidiary, Airborne Express. In 1983, DHL Airways, an established international air courier, entered the domestic expedited mail market. Roadway Package System (RPS) entered the ground package delivery market in 1985.

The Postal Service identified FedEx, UPS, Airborne, DHL, and RPS as its chief competitors for expedited mail and package deliveries. To indicate their importance as competitors, we compared the revenues of the Service's domestic Express Mail, Priority Mail, and fourth-class business

[24]See U.S. Postal Service: Pricing Postal Services in a Competitive Environment (GAO/GGD-92-49, March 1992).

mail with the total domestic revenues reported by the five firms for all of their expedited and ground parcel services.[25] The aggregate domestic revenues for these services were about $31.7 billion in 1994. Of that total, the Postal Service's share was just under 15 percent.[26] Our analysis also showed that the Postal Service's share of total revenue in the expedited letter and package markets was less than the shares of either UPS and FedEx but greater than those of Airborne, RPS, and DHL. (See fig. 3.1.)

Figure 3.1: 1994 Domestic Expedited, Deferred, and Parcel Delivery Market Shares (in Billions of Dollars)



Source: GAO analysis of U.S. Postal Service and industry data.

[25]More detailed comparisons by product lines were not possible because the competitors did not make sufficient data publicly available.

[26]If an estimated $600 million in additional revenues reported by the Postal Service for delivery of First- and third-class parcels were included, the Service would pick up one additional point of market share, to 16 percent, while both UPS and FedEx would drop one point each. The other carriers' shares would be unchanged.

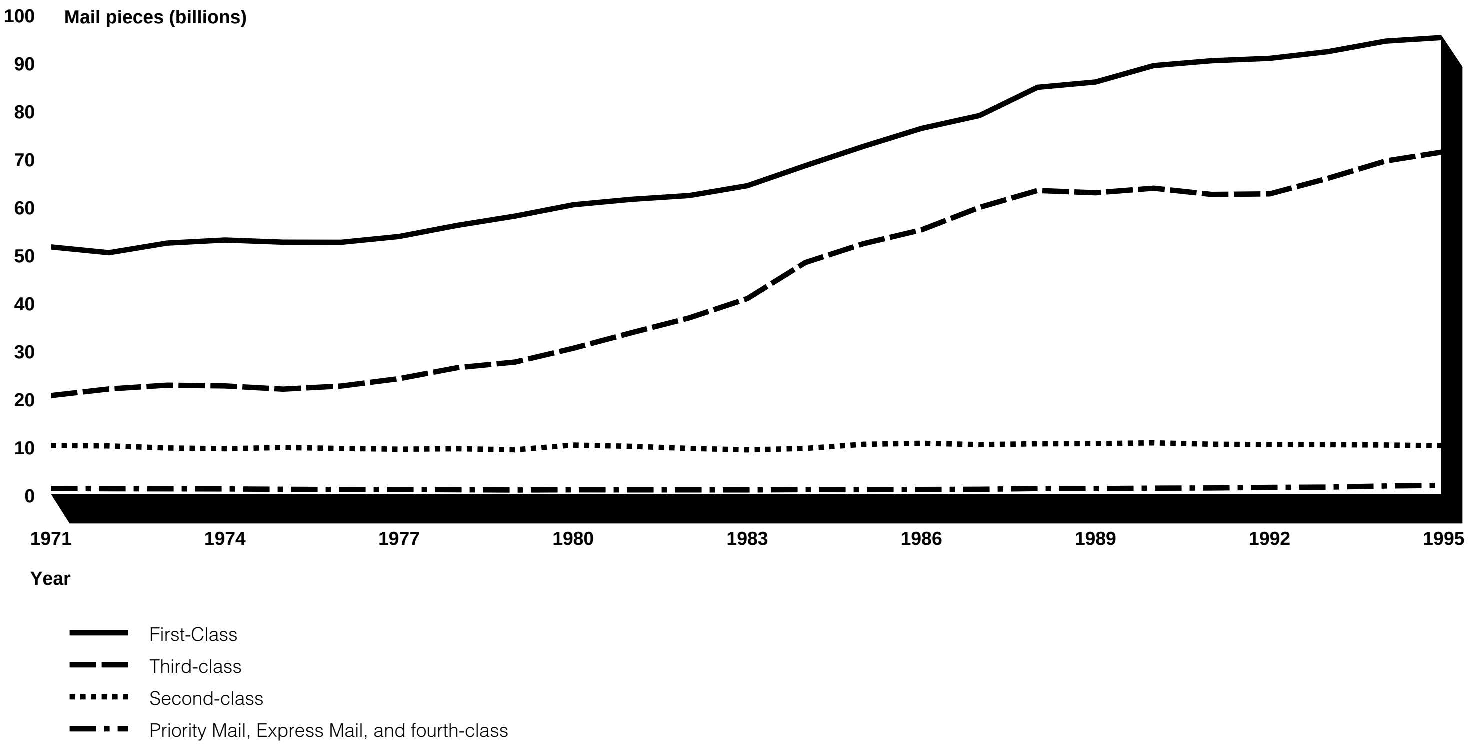
Postal Service officials estimated that the Service's share of the expedited delivery market was 18 percent in 1994 and declining. A Postal Service marketing official attributed the loss of expedited mail volumes to the following four factors:

- the Postal Service's inability to engage in carrier "price wars" common to the highly competitive, expedited mail market, and the Service's inability to offer discounted postal rates to high-volume customers;
- competitors' greater capacities to provide shipment-related information services, such as automated package tracking and tracing;
- the less extensive geographic "reach" of the Service's dedicated Eagle air transportation network, which limits the number of locations where the Service consistently has been able to match or exceed its competitors' "next-day, morning" delivery performance; and
- public perceptions that private express carriers offer more dependable service than the Postal Service.

Conversely, Service officials estimated that in 1994 the Service's share of the ground parcel delivery market was 15 percent and growing. They attributed this growth primarily to three factors. First, because of higher per-piece delivery costs to residential areas, UPS and RPS have imposed surcharges for residential ground parcel deliveries in recent years, thereby making the Service the low-cost provider in the more cost-sensitive, residential segment of the parcel market. Secondly, the Service improved its performance for parcels drop-shipped for delivery within geographic areas covered by the Service's bulk mailing centers. Thirdly, the Service improved its service by forwarding packages to recipients' work locations or leaving packages at residences when no one was home, so customers did not need to make a trip to the delivery post office during specified service hours to retrieve the package.

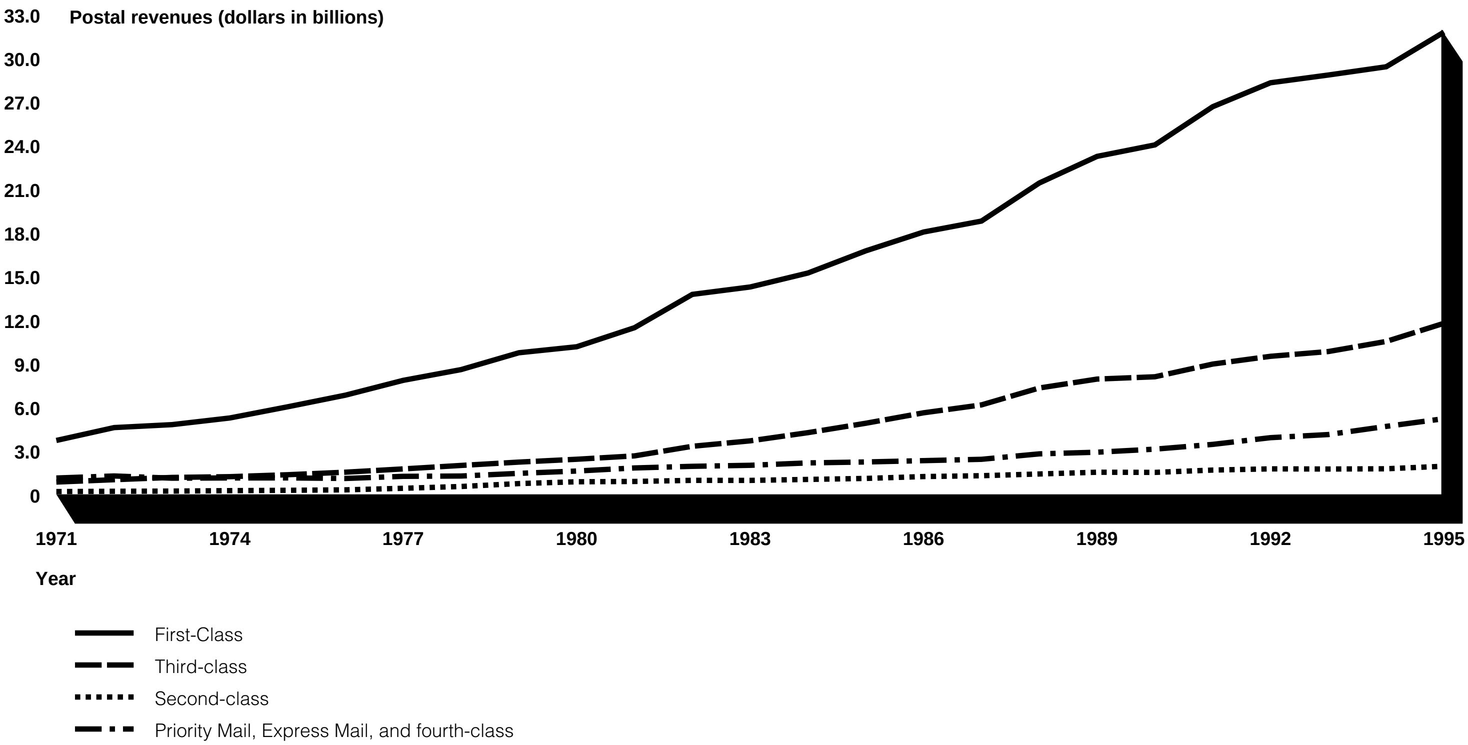
Although the Service has lost market share in the expedited letter and parcel markets over the years, its overall mail volume has continued to grow since 1970. This growth was attributable primarily to increases in mail volumes and revenues for those mail classes largely protected by the Statutes, First-Class and third-class. By comparison, volumes and revenues in those mail classes and subclasses subject to full or significant competition have shown relatively little growth, as shown in figures 3.2 and 3.3.

Figure 3.2: Changes in Domestic Mail Volume by Class, 1971 to 1995 (Billions of Pieces)



Source: U.S. Postal Service data.

Figure 3.3: Changes in Postal Revenue by Mail Class, 1971 to 1995 (Billions of Dollars)



Source: U.S. Postal Service data.

We recently reported that compared to private delivery firms, the Postal Service's competitive position in the international mail market also eroded after it suspended the Statutes for outbound international letters in 1986.[27] Since that time, private carriers have come to dominate this market, notably FedEx and DHL. Together, these two firms accounted for more than half of the $3.5 billion in total international mail revenues in 1992. The Service's share of the international mail market declined because private firms offered more competitive services and prices.

[27]The international mail market consists of standard letter mail, expedited letters, and packages. Private carriers dominate the expedited and package segments of the market, while the Postal Service still handles most of the standard letter segment. For more information, see: U.S. Postal Service: Unresolved Issues in the International Mail Market (GAO/GGD-96-51, March 1996).

Most Major Private Delivery Firms Offer Deferred (2-Day and 3-Day) Package Delivery Services

All but one of the Postal Service's principal competitors for expedited letter and parcel delivery services—DHL—also offered deferred (2-day and 3-day) package delivery services, and most were adding other services at the time of our review. None of those five firms disclosed detailed operating data by product line or type of service. However, we were able to compare publicly available data on the kinds of services offered with similar services offered by the Postal Service, as shown in table 3.1.

Table 3.1: Comparison of Services Offered by Expedited and Parcel Delivery Competitors

Carrier	Same-day express	Overnight letters	Overnight packages	Deferred letters	Deferred packages	Ground parcels
Postal Service	Yes[a]	Yes	Yes	Yes	Yes	Yes
Airborne	Yes	Yes	Yes	No	Yes	No
DHL	Yes	Yes	Yes	No	No	No
FedEx	Yes	Yes	Yes	No	Yes	No[b]
RPS	No	No	No	No	Yes	Yes
UPS	Yes	Yes	Yes	Yes	Yes	Yes

[a]Available only between selected airports.

[b]FedEx plans to offer a ground parcel service in 1996.

Source: GAO analysis of industry data.

Of the services listed in table 3.1, only deferred letters are covered by the Private Express Statutes. As indicated, four of the five private carriers offered deferred package service. Only one of the five carriers publicly offered a deferred letter service.[28] If the Statutes were relaxed to permit private carriers to deliver deferred letters, it appears the remaining firms easily could add letters to their deferred delivery services for the localities they now serve.[29] Thus, whether private firms deliver larger volumes of letter mail in the future appears to depend less on private delivery capacity than on statutory restrictions or the profitability of such deliveries.

Although the Postal Service considers the five carriers discussed above to be its most prominent competitors, many other private firms also offer

[28]UPS charged $6 for a 2-day letter, or twice the applicable Priority Mail rate that became effective January 1995. Postal Service regulations say that the "urgency" requirement for private letter delivery is presumed to be met if the rate for such delivery is twice the applicable First-Class rate, including Priority Mail, or $3.00, whichever is greater.

[29]We were not able to obtain from the five principal competitors specific data on localities they serve. However, some of the competitors, such as Airborne, FedEx, and UPS, advertise broad geographic service areas by publishing lists of ZIP Code areas they serve.

expedited mail delivery services. As one indication of the number, the Air Courier Conference of America, a trade association whose member firms compete with the Postal Service, reported that it had 78 members in 1995, including most of the Postal Service's principal competitors. Similarly, the Express Carriers Association listed 64 ground package express carriers in its 1995-96 directory. Most of these carriers serve regional or local markets as an "alternative to the regular common carrier."

Private Carriers Are Likely to Compete Aggressively for Deferred Letter Delivery

As indicated above, private carriers have continued to dominate the expedited letter and parcel markets since our 1992 report. At that time, private carriers reported that they were eager to expand their deferred delivery business and to compete for a greater share of the Service's Priority Mail volumes.

Our current review showed continued strong interest in second-day and third-day mail delivery. Some of the carriers that offered deferred letter or package delivery services (Airborne, FedEx, RPS, and UPS) acknowledged that such services had been among their fastest growing business segments in recent years, though none were willing to provide specific data. They generally predicted continued strong growth in the deferred delivery market.

Priority Mail represents the majority (about $3 billion, or nearly 58 percent) of the combined revenues from the Postal Service's Express, Priority, and fourth-class mail services in fiscal year 1995. Priority Mail is a category of First-Class mail that the Service has marketed as a competitively priced, 2- or 3-day delivery service available throughout its domestic service areas. Postal Service officials estimated that as much as 70 percent of approximately 869 million Priority Mail pieces handled in fiscal year 1995 were letters covered by the Private Express Statutes.

Private Advertising and Publications Delivery Capacity Has Grown Rapidly

Notwithstanding statutory restrictions on letter mail delivery, about 375 predominantly local and mostly small delivery firms operate in 47 states and compete in a fast-growing advertising mail market, a subscriber publication delivery market, or both. Known collectively as the "alternate delivery industry," these firms compete with the Postal Service for the delivery of third-class advertising mail that does not fall within the definition of a letter and for second-class publications mail. According to an industry group, the Association of Alternate Postal Systems (AAPS), these firms "provide delivery and distribution of circulars, tabloids, magazines, catalogues, directories, flyers, samples and other printed material and advertising outside of the U.S.P.S. mail stream." The number of these firms grew rapidly in the late 1980s and early 1990s. More recently, many have entered into nationwide alliances to market their services to national advertisers and publishers. Collectively, they represent a significant and growing source of additional private sector competition for mail delivery.

Growth Has Occurred Largely Since 1988

From the information we obtained, we determined that the contemporary alternate delivery industry began to take shape in the 1970s and grew rapidly in the 1980s and 1990s. From 1982 to 1994, the number of alternate delivery firms increased from 108 to 387, but they declined slightly to 375 in 1995. Most new start-ups (226 of the 375 firms) occurred over roughly a 5-year period, from 1988 to 1993.

Several events stimulated expansion and transformation of the industry in the 1980s. One was the growth of computerized database marketing programs that allowed advertisers to target direct mail advertising to specific geographic and demographic groups. This led to a proliferation of highly customized household mailing lists, which also contributed to significant growth in third-class advertising mail delivered by the Postal Service. In addition, three significant increases in the Service's third-class postage rates that became effective in 1988, 1991, and 1995 prompted some advertisers to seek lower cost delivery alternatives.

Another event, and one that many industry experts believe was of greatest significance, was the growing participation of newspapers and other publishers in alternate delivery ownership and operations. Newspaper publishers owned about three-fourths of the firms that entered the market between 1988 and 1994. These publishers, who account for the largest share of the overall advertising market, traditionally relied heavily on revenue from advertisements printed within a newspaper's pages, known in the trade as "run of press" advertising. However, many advertisers have shifted to less expensive advertising inserts. As this change took place, newspaper publishers found themselves increasingly in direct competition with the Postal Service. For example, in discussions with us, newspaper industry representatives were outspoken about losing revenue to the Postal Service and the implications of any such losses to the financial health of the newspaper industry.

The developments highlighted above both stimulated new entrants to the advertising delivery market and contributed to an unprecedented growth in the Postal Service's advertising mail deliveries, despite rate increases. As previously illustrated in figure 3.2, the Postal Service delivered about 20 billion pieces of third-class mail in 1971 compared to about 71 billion pieces in 1995. As indicated previously in figure 3.3, this growth rate far exceeded that of the larger First-Class category and significantly narrowed the gap between First- and third-class mail.

Household Deliveries Made Without Addresses or Mailboxes

According to Postal Service regulations, advertising matter under 24 pages and addressed to a specific person or occupant is "letter mail" and thus subject to the Statutes. However, the firms we studied and the Postal Service have found innovative ways of targeting and delivering advertisements to households without using an addressed envelope.

Alternate delivery firms we interviewed used a variety of delivery strategies. Many firms made "saturation" deliveries once a week to households to deliver such items as advertising flyers, local government notices, product samples, unpaid community newspapers, and telephone directories. Typically, items were placed in plastic bags and hung on a door knob, placed on a front porch, hung from a hook placed on the mailbox post, placed in a delivery tube attached either to its own stand or a mailbox post, or tossed onto driveways or walkways.

For alternate delivery firms owned by newspapers, the core delivery product is what they call a "total market coverage" (TMC) package. Generally, a TMC package includes at least one item, such as a free community newspaper or a weekly entertainment supplement, that would qualify for second-class postage rates on the basis of its editorial content if sent through the mail.[30] TMC packages also include advertisements identical or similar to newspaper advertising inserts. The primary purpose of TMC deliveries is to ensure distribution of advertisers' messages beyond the newspaper's subscriber base alone. Because the TMC packages also include an item qualifying as a second-class publication, alternate delivery firms do not consider TMC packages to be covered by the Statutes and the Postal Service agrees. Most newspaper-owned alternate delivery firms also deliver one or more of the following products, either concurrently or

[30]Some newspapers use the mail in part or in whole to deliver TMC packages. According to the Newspaper Association of America, newspapers responding to a 1994 survey indicated that their primary alternate delivery routes were about 78 percent private carrier and about 22 percent U.S. mail. Of 680 newspapers that responded to the survey (about a 42 percent response rate), 261—approximately 38 percent—said they were involved in alternate delivery.

separately from TMC deliveries: saturation advertising and product samples, weekly newspapers and shoppers' guides not otherwise contained in TMC packages, and consumer magazines and catalogs. Private delivery of the latter, however, has declined since 1994.

The Postal Service also delivers some third-class advertising mail to occupants and boxholders at specific addresses without an address label on the mail itself. For example, ADVO, Inc., one of the Postal Service's largest customers, specializes in delivering "marriage mail" by combining pieces from several advertisers in a single mailing. An address card, which is separate from the advertising pieces, is sent on the same day. Many product samples are delivered in the same manner. However, the Postal Service describes this mail as "detached label" and still considers it to be "addressed." Overall, about 17 percent of the Service's regular third-class advertising mail was addressed to occupants and boxholders in fiscal year 1994,[31] regardless of whether labels were affixed or detached.

More recently, in 1995, the Postal Service announced it was planning to implement an experimental "Neighborhood Mail" program. In this program, the Service proposed to allow mailers to send advertising materials only to "Neighbor" or "Postal Patron" and to eliminate the requirement that it bear a specific street or box address. The purpose of the neighborhood mail program was to provide lower advertising delivery rates to small, local businesses for unaddressed, saturation mail that did not require significant handling and processing by postal employees. The planned program encountered strong opposition, primarily from the newspaper industry, advertising mailers and companies that provide support services to mailers (such as address lists and labels), and the alternate delivery industry. Consequently, the Service deferred the test and later announced that it would not be done at all.

Some newspaper and alternate delivery executives perceived the proposed neighborhood delivery program as an attempt by the Service to take business from them. They questioned the Postal Service's choice of sites, such as Baton Rouge and New Orleans, Louisiana; Rochester, New York; and Sacramento, California, where alternate delivery firms were already operating. These executives were most concerned about the Service's choice of Rochester. That city's major newspaper had discontinued a delivery operation in 1995, reportedly after failing to make a profit.

[31]The Postal Service conducts a biennial "Household Diary Study" of "mail originating and destinating in households." According to its fiscal year 1994 study, about 71 percent of all regular, third-class mail was received by households. The portion addressed only to occupant or box holder noted above is expressed as a percentage of <u>all</u> third-class mail, not just household mail.

Subsequently, Publishers Express (PubX), a national alternate delivery network with which the newspaper had been affiliated, established its own alternate delivery operation in March 1995. Rochester was the only location nationwide where the firm performed its own deliveries instead of working through a local affiliate; a company official believed PubX had been targeted for harassment by local postal officials and workers.

National Alliances Have Been Formed and Are Growing in Size and Diversity of Services

A common characteristic of the alternate delivery firms we reviewed was the goal of increasing the volume and variety of items delivered in order to develop and sustain profitable delivery operations. One strategy used to accomplish this objective was the formation of national delivery alliances. Several such organizations have been established, some of which are discussed below. To the extent that several large publishers were involved as founders of or investors in such organizations, they were primarily motivated by a desire to reduce mailing costs and improve delivery service. Locally owned delivery companies affiliated with national networks in order to benefit from the collective marketing of members' delivery services to national advertisers or publishers. Of about 261 newspapers engaged in alternate delivery that responded to a 1994 survey conducted by the Newspaper Association of America (NAA), about one-quarter indicated they were affiliated with national delivery networks.

Advertising Delivery Organizations

All of the firms included in our review that were owned or operated by newspaper publishers had contract or licensing agreements with one of two national alternate delivery marketing organizations. One of these organizations, Alternate Postal Delivery (APD), Inc., is headquartered in Grand Rapids, Michigan. Originally formed in 1978, APD issued its first stock offering in 1995 and now is publicly traded. APD has a network of about 40 private delivery affiliates capable of delivering address-specific items to about 10 million households and saturation materials to about 30 million households.

The second organization, PubX, was established in 1989 by a group of equity partners led by Time, Inc., and included other magazine publishers, catalogers, printers, and paper companies. PubX, which was headquartered in Marietta, Georgia, built a national network through licensing agreements with predominantly newspaper-owned alternate delivery firms. The number of PubX licensees peaked at 32 in 1994; collectively, they delivered about 60 million pieces that year. However, PubX licensees declined to around 25 by mid-1995, and some of the remaining licensees cut back on second-class magazine deliveries, which constituted the core of PubX's business.

Both APD and PubX tried several marketing strategies to increase the volume of pieces delivered. Officials of both firms said that to deliver magazines profitably and at rates lower than the Postal Service's second-class postage rates depended on developing a market for so-called "ride-along" advertising, i.e., normally third-class mail pieces that may be delivered to specific addresses when included as inserts with second-class publications. However, ride-along advertising did not develop as fully as anticipated, and many newspaper publishers reduced or terminated magazine deliveries arranged through APD or PubX. Largely as a result of the decline in private magazine deliveries, the combined number of APD and PubX affiliates dropped from 82 in 1993 to 47 by the end of 1995.

APD and PubX also have sought to increase the use of alternate delivery by mail order catalog publishers. Toward that end, some of these publishers participated in a 1994 catalog delivery test coordinated by the Direct Marketing Association (DMA). Overall, however, DMA found that Postal Service delivery resulted in more orders and higher dollar sales than private delivery of the same catalogs. Separately, a representative of the Mail Order Association of America said that for large nationwide catalogers, any delivery cost savings associated with alternate delivery were not great enough, given the industry's relatively limited geographic reach when compared to the Postal Service, to justify shifting portions of their deliveries to private carriers and bearing the additional administrative costs of using multiple service providers.

Nonetheless, the JC Penney Company, one of the nation's largest catalogers, had distributed a portion of its catalogs through former PubX licensees. In January 1996, it terminated its agreement with PubX and reverted to Postal Service delivery in those markets.

In February 1996, PubX's board of directors voted to discontinue all operations. The board cited a number of factors for the decision, including a period of stable postal rates, the "historically low" increase in second-class rates that became effective in January 1995, improved service by the Postal Service, and the Service's strong financial results in fiscal year 1995. The board said that "the recent improvements within the Postal Service have diminished the need for a hard copy delivery alternative. However, if the USPS cost trends revert to prior levels, hard copy delivery alternatives will once again develop."

In a speech presented to the National Association of Postmasters of the United States on February 20, 1996, Postmaster General Marvin Runyon claimed credit for driving PubX out of business:

> "We ran them out of business by improving service and keeping costs low! I can't say that I am sorry to see them go. But they taught us two valuable lessons. First, if we don't do our jobs, somebody else will. And second, when we get our act together, we can be one hell of a competitor."

APD and PubX also pursued, unsuccessfully, changes in Postal Service regulations to permit greater competition with the Service for the delivery of advertising letter mail. As previously noted, they and other parties were members of the Coalition for the Relaxation of the Private Express Statutes that petitioned the Postal Service to suspend the letter mail monopoly for some or all third-class mail in January 1995. The Coalition founder told us that its principal target was catalogs of less than 24 pages.

Despite the strong interest expressed by alternate delivery firms in expanding their business, industry leaders have acknowledged that they have a long way to go to increase capacity to levels that would represent a significant competitive threat to the Postal Service. In its September 1995 stock prospectus, APD said that "to present a viable alternative to USPS delivery and to attract a substantial number of national customers, [it] must expand the scope of its delivery services to additional ZIP Codes across the United States, including additional major metropolitan areas." As an indication of APD's aggressiveness in this regard, it announced in February 1995 that it had signed letters of intent to add 12 former PubX licensees to its affiliate network.

Publications Delivery Organizations

We obtained information on two national organizations that primarily delivered publications—the National Delivery Service (NDS), of Princeton, New Jersey; and Nationwide Alternate Delivery Alliance (NADA), which is co-located in Washington, DC, and New York. Both organizations compete with the Postal Service for the delivery of second-class mail and had plans to expand their delivery operations.

NDS is a subsidiary of Dow Jones and Company, which publishes The Wall Street Journal and Barron's. Dow Jones began testing alternate delivery of the Journal to business subscribers in the 1970s because the publisher did not believe that the Postal Service could meet its subscribers' demands for timely delivery, i.e., by the start of the business day. NDS was established as a separate organizational division of Dow Jones in 1981. NDS did not deliver advertisements and had no plans to do so, according to an NDS official.

NDS initially delivered the Journal primarily to businesses but expanded deliveries to residential subscribers. By July 1995, Dow Jones had shifted about two-thirds of the Journal's estimated 1.55 million daily domestic subscriptions from the Postal Service to NDS, about 60 percent of which NDS delivered to businesses and the balance to residences. NDS also delivered about 1.3 million copies of Barron's each year to business and residential subscribers. NDS has begun to sell delivery services to other publishers but has limited the service to business publications. On the basis of information provided by an NDS official, we estimated that NDS delivered roughly 280 million second-class publication pieces in 1995.

In 1995, NDS's work force included about 3,500 carriers, over 90 percent of whom were part-time workers. NDS also relied on some independent contractors and, increasingly, affiliate newspapers to make deliveries. An NDS official said that under the affiliate program, participating newspapers' carriers deliver the Journal at the same time they deliver the local daily newspaper. Eventually, he said this will allow NDS to shift most of the remaining Journal subscriptions from the Postal Service to private delivery.

The other national delivery organization, NADA, was formed in 1990 to market the collective delivery capabilities of its members to national business publishers. In July 1995, NADA membership included 74 independent newspaper and publication distributors operating in 55 metropolitan markets. According to NADA's president, affiliates deliver only second-class items, not third-class advertising material. Affiliates in larger markets typically deliver roughly equal numbers of newspapers and business publications primarily to businesses. Affiliates in smaller markets typically deliver about 75 percent newspapers and 25 percent business publications. He said that if the Statutes were changed to permit more private delivery, some affiliates might expand into third-class delivery. Collectively, NADA affiliates delivered about 5 million pieces every week, or about 260 million pieces annually.

Postal Service Still Delivers Most Advertisements and Periodicals, but Private Delivery Could Grow

Although the Postal Service delivers the vast majority of advertisements and periodicals, the volume of these items delivered by private firms could grow in future years if the Statutes were to be relaxed or repealed.

We obtained from an industry official estimates of about $500 million in annual private advertising delivery revenue, which reportedly includes "both local delivery markets throughout the United States and the smaller national delivery market." This revenue, when combined with the Postal Service's total revenues from advertising mail of about $12.7 billion for fiscal year 1994, indicates that the industry's portion of the total advertising delivery market was about 4 percent. By combining volume estimates provided to us by selected national firms, we developed an indication of the magnitude of private periodical deliveries. The combined annual volume estimates provided by NDS and NADA were about 540 million pieces. (Due to the discontinuation of PubX operations in 1996, and the general decline in alternate delivery of consumer magazines to residential subscribers, we excluded APD and PubX second-class delivery volumes from our analysis.) The Postal Service delivered about 10.2 billion pieces of second-class mail, mostly periodicals, in fiscal year 1995. When compared with the NDS-NADA volumes, the Postal Service delivered about 95 percent and those organizations and their affiliates about 5 percent of the total.

The Postal Service could face greater competition for delivery of advertisements and periodicals if the Statutes were relaxed or repealed because relatively minimal investment is required to provide these services. A Service official also told us that with greater competitive freedom, mail presort bureaus could enter the private delivery market by expanding current operations or forming alliances with alternate delivery firms. Because presort bureaus already regularly receive and sort letters for many mailers, the official suggested that acquisitions, mergers, alliances, or other business arrangements between these bureaus and alternate delivery firms could be quite profitable ventures.

Estimated Financial Effects of Changing the Private Express Statutes Vary Among Mail Classes

Primarily on the basis of (1) existing private mail delivery capacity, (2) private firms' actions and stated interests regarding expansion of mail delivery services, and (3) interviews with mailers, we determined that a greater percentage of Priority Mail volumes than other classes of letter mail would be at immediate risk if the Private Express Statutes were to be relaxed or repealed. Lower percentages of First-Class and third-class letters also could be diverted to private delivery, but probably not as quickly or to the same extent as Priority Mail.

On the basis of the Service's revenue and cost data, the financial effects of volume losses would vary greatly among those classes of mail largely comprised of letters. A loss of most or all Priority Mail would have a lesser effect on postage rates than a smaller loss, such as 5 to 10 percent, of First-Class letter volume. Similarly, a loss of 25 percent of the protected third-class mail would have about the same effect on the price of the First-Class stamp as a 5-percent loss of First-Class letter volume. However, a range of factors could increase or decrease the Service's future mail volumes and postage rates. This makes it difficult to estimate how a change in the Statutes might affect the Service's finances and postage rates.

The Risks of Potential Mail Volume Losses Differ Among the Letter Mail Classes

On the basis of our interviews with the Postal Service's competitors and mailers as well as analysis of various Service revenue, cost, and postage rate data, we assessed (1) the relative risk of volume losses of First-Class, Priority (a subclass of First-Class), and third-class mail, which make up most of the Service's letter mail protected by the Statutes; and (2) the estimated effects of such losses on postage rates, particularly the basic First-Class letter mail rate, which is currently 32 cents. Our assessment showed that the risk of loss and the likely impact of such loss at the time of our review and in the near term would vary among the three segments of the Service's mail stream. (See table 4.1.)

Table 4.1: Assessment of Relative Risk and Likely Financial Impact of Changing the Private Express Statutes

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

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

Source: GAO analysis of industry data.

Included in our analysis of the risk of loss were structured interviews with private, nationwide express and parcel carriers identified by the Postal Service as its chief competitors (Airborne, DHL, FedEx, RPS, and UPS); a judgmental sample of alternate delivery carriers of varying sizes located throughout the United States, including both newspaper and independently owned firms; and various organizations, mostly nonprofit associations, who collectively represented most of the nation's commercial and institutional mailers.[32] We also assessed the sensitivity of such losses by using 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, which was developed by Price Waterhouse LLP (Price Waterhouse) under contract with the Postal Service.

As discussed below, the risk of loss varied among the mail stream segments because of (1) differences in delivery capacity, prices, and past competitive actions of private firms that might deliver certain letters that now are protected under the Statutes; (2) the extent to which mailers indicated that they were satisfied with current service and rates; and (3) differences among mailer representatives relative to actions they might take in response to changes in the Statutes. The financial effects of volume losses also would vary, by mail class, due to differences in the overall contribution to the Postal Service's overhead costs among the various classes.

Priority Mail Letters Are at Greater Risk Than Those in Other Classes

Private delivery firms already have the capacity to deliver a significant portion of those letters designated as Priority Mail, currently covered by the Statutes. Priority Mail consists of both letters and packages. Because such mail is sealed from inspection, the Service does not know how many Priority Mail pieces are letters, but it estimates that as many as 70 percent are. Of the three letter mail classes and subclasses, Priority Mail would be most susceptible to immediate and strong competition if the Statutes were changed to allow competitors to set prices freely and deliver such letters.

[32]In selecting mailer groups, we sought to identify organizations that represented the major mailers for each class of mail, including those that generally were open to competitive delivery. A complete list of all structured interview respondents, both carriers and mailers, is included in appendix III.

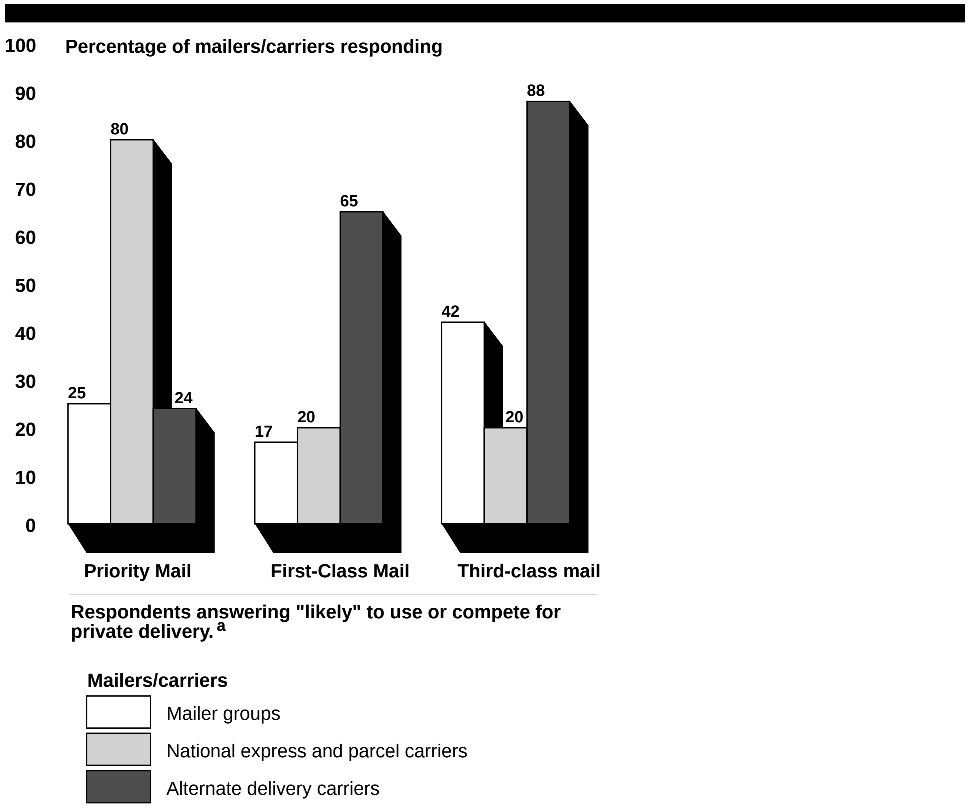
Private Carriers Appear Eager and Able to Deliver Priority Mail

As noted earlier, Priority Mail is a subclass of First-Class mail. The minimum rate is $3.00 for Priority Mail pieces. Under current Service regulations, competitors must charge at least $6.00, or double the applicable Priority Mail rate, to provide expedited, 2- or 3-day delivery of items defined as letters and weighing 12 ounces or more. We asked private carriers the extent to which they would pursue delivery of protected letters, and we also asked mailers the extent to which they might divert such letters to private carriers, by mail class and subclass, if the Statutes were changed.

Of the Service's principal competitors, national express/parcel carriers, four out of five said they were likely to pursue delivery of Priority Mail letters. Specifically, three said they were "very likely" and one said it was "somewhat likely" to seek additional 2-day letter business; only one said it was unlikely to do so. By contrast, alternate delivery carriers, who compete largely for second-class publications (mostly newspapers, magazines, and other periodicals) and third-class advertising and lack the nationwide delivery infrastructure of the national carriers, expressed little interest in delivering Priority Mail. Only 4 of 17 (24 percent) said they were likely to seek a share of the Priority Mail letter business if the Statutes were changed. (See fig. 4.1.) Only 3 of 12 (25 percent) mailer groups told us they were likely to divert Priority Mail letters to private carriers if the Statutes were modified, and 2 more said they were as likely as unlikely to do so. Of the remainder, five said they were unlikely to do so, and two were undecided.[33]

[33]Of the 14 mailer groups we interviewed, 2 were national newspaper associations. Although they represented the majority of the Service's second-class customers, many of their members also are engaged in alternate delivery. Consequently, questions normally posed to mailers about their intentions to use private carriers for various classes of mail if the Statutes were changed were posed to these two groups in terms of whether their members intended to deliver various classes of letter mail if the Statutes were changed. Those responses have been included with our results from structured interviews with alternate delivery organizations, thus accounting for only 12 rather than 14 responses to certain mailer questions.

Figure 4.1: Mailer and Carrier Interest in Private Delivery by Protected Mail Classes



[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 interview data.

Both in our 1992 report and in our more recent discussions with private carriers and Postal Service officials, we obtained other information that suggested Priority Mail may be at greatest risk for immediate and substantial volume losses to private carriers. For example:

- Nationwide private carriers may be able to meet or surpass the Postal Service from a competitive perspective in terms of price, range of services, and reliability.
- Airborne, FedEx, and UPS each claim to deliver to virtually all domestic U.S. addresses; RPS expects to be able to do so by the end of 1996; and DHL advertises its overnight service is available "to all major U.S. business

centers." Thus, most of the private express and parcel carriers say that they maintain essentially universal delivery networks.

- National carriers already have lobbied Congress to suspend the double-postage rule, discussed in chapter 2, in an effort to facilitate adding letters to their deferred package deliveries.
- Declining growth in next-day morning deliveries has caused overnight carriers to consider expanding into the fast growing but less expensive next-day afternoon, second-day, and third-day delivery markets. This trend is reflected in the Postal Service's Priority Mail volume, which increased nearly 64 percent between 1990 and 1995, from about 518 million to 869 million pieces, while its Express Mail (next-day) volume declined about 3 percent.
- Some expedited mail delivered by private carriers is too large to fit in residential mailboxes, is delivered inside to businesses, or requires a signature for delivery. Consequently, most private carriers we interviewed said they are not dependent on greater access to mailboxes in order to expand deferred deliveries.
- Unlike the Postal Service, private carriers are able to offer both volume and negotiated discounts to their customers. Further, many mailers perceive private carriers as more reliable than the Postal Service and find their tracking and tracing services superior to those of the Postal Service.
- Priority Mail generates high revenue per mail piece, making it especially attractive to private carriers. In 1994, on average, Priority Mail generated gross revenue of $3.45 per piece and net revenue of $1.79 per piece, compared to gross revenue of about 35 cents per piece and net revenue of 12 cents per piece for First-Class mail.[34] For fiscal year 1995, Priority Mail represented less than one-half of 1 percent of all mail pieces handled by the Service but generated almost 6 percent of total revenues.
- As noted in chapter 3, the five principal nationwide carriers already command an overwhelming share, about 85 percent, of the combined overnight, 2- and 3-day, and parcel delivery markets.

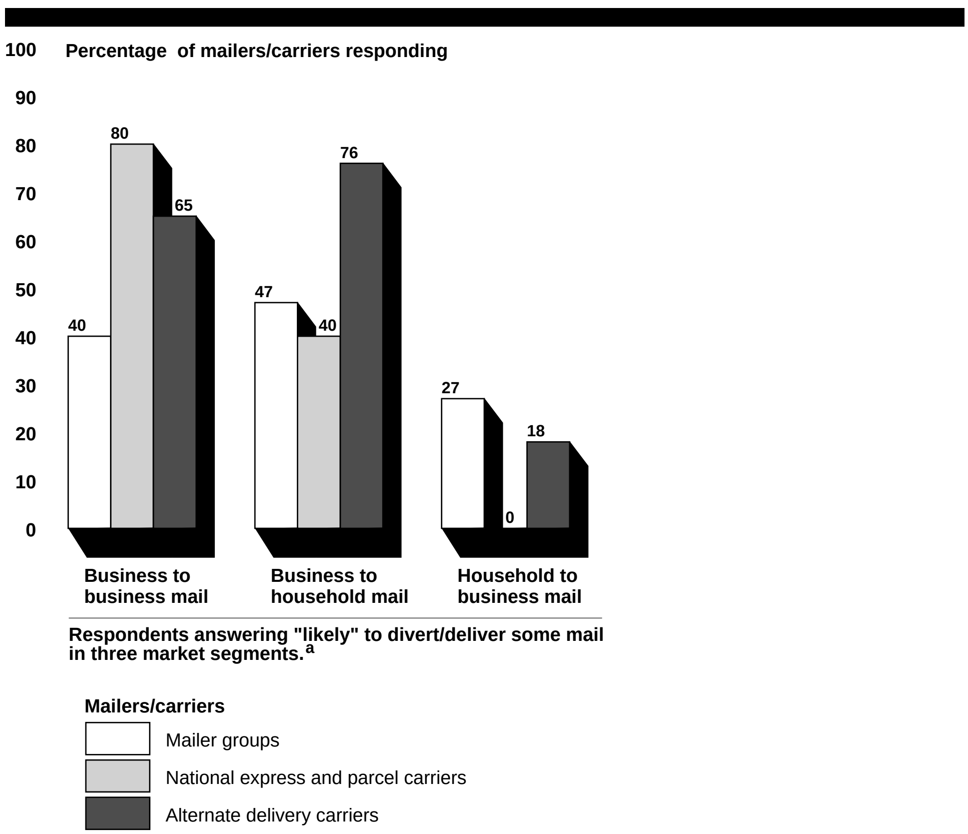
The Service measures its mail volume on the basis of the following origin and destination pairs: business-to-business, business-to-household, household-to-business, and household-to-household. In 1994, about 90 percent of all mail was generated by businesses (about 55 percent of all mail went from businesses to households, and 35 percent went from businesses to businesses), while 10 percent emanated from households. We asked private carriers whether they were most interested in providing business or residential service. We asked mailers in which of those market

[34]Net revenue is total revenue for a mail class or subclass, less its attributable cost.

segments they were likely to divert some mail to private carriers if given greater freedom to do so.

Among the five national express/parcel carriers, all but one said they were “somewhat” or “very likely” to pursue additional business-to-business deliveries. The remaining carrier said it was as likely as unlikely to do so. However, only two of the five carriers (40 percent) said they were likely to pursue a greater share of the business-to-household delivery market, while two others said they were as likely as unlikely to do so. None said they were likely to pursue household-to-business deliveries, although one indicated it might be as likely as unlikely to consider that market segment. The vast bulk of Priority Mail falls into the first two categories. (See fig. 4.2.)

Figure 4.2: Mailer and Carrier Interest in Private Delivery by Market Segment



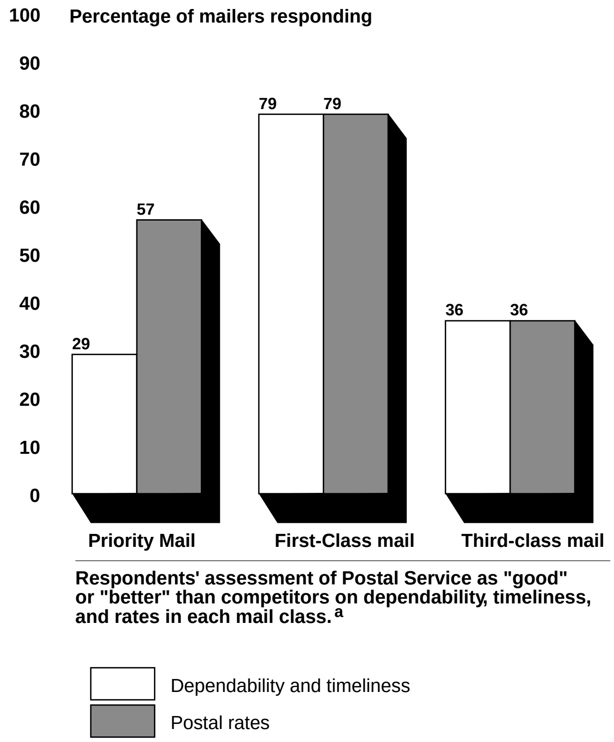
[a]Each group was separately asked about their interest in mailing or delivery (1) business to business mail, (2) business to household mail, (3) household to business mail. (Only the "likely: response is shown (i.e., "very likely" and "somewhat likely" combined).

Source: GAO interview data.

Many Mailers Did Not Assess Priority Mail as Better Than Its Competitors and Some Would Switch to Private Carriers

We asked mailers to assess the Postal Service's performance relative to its competitors for largely protected mail classes and subclasses. Specifically, we asked them whether the Service's performance on (1) timeliness and dependability of mail delivery and (2) postage rates was better, as good, or worse than its competitors. The overall results of our interviews where we combined responses for "as good" and "better" are shown in figure 4.3.

Figure 4.3: Mailer Assessment of Postal Service Delivery and Rates for Protected Mail Classes



[a]Mailers were asked their views on whether the Postal Service was better, as good, or worse than its competitors on the dependability and timeliness of each mail class and on the rates for each class. Only the combined responses "as good" or "better" are shown.

Source: GAO interview data.

Our interviews showed that overall, mailers did not rate Priority Mail service well in comparison to service provided by private carriers. Only 4 of 14 mailers (about 29 percent) said that the Service was as good or better than its competitors with regard to service timeliness and dependability. Specifically, only one said Priority Mail service was better than that provided by private carriers, three said it was about the same, six said it was somewhat or much worse, and four had no opinion. The Service's on-time delivery rates for Priority Mail generally have been below 90 percent. For example, during fiscal year 1995, the Service delivered 82 percent of Priority Mail shipments within its 2-day standard and 94 percent within 3 days.

Among the same respondents, 8 of 14 (57 percent) said that Priority Mail rates were as good or better than private carriers' rates, 2 said the Postal Service charged more than its competitors, and 4 had no opinion. As noted in our 1992 report and confirmed in discussions with nationwide carriers and mailers, Priority Mail users generally tend to be more price-sensitive than overnight mailers.

On the basis of our overall assessment of industry capacity and interest, we believe that if private delivery of Priority Mail letters were to be permitted and the double-postage rule were eliminated, carriers would offer discounted rates to volume mailers for deferred letters as they now do for overnight services and deferred package deliveries. This likely would reduce or negate the Service's perceived price advantage and encourage even more mailers to divert Priority Mail letters to private carriers.

The actual price that competitors might charge for deferred (second-day) delivery of letters cannot be determined easily for at least two reasons. First, pricing data are not readily available to the public because private carriers do not publish their best prices. They are offered through individual contracts with customers and considered by the carriers to be proprietary data. Secondly, the lowest prices that private carriers might charge on the basis of their actual cost is difficult to predict because the Service's double-postage rule results in an artificial price "floor" on rates private carriers must charge for urgent letter delivery. We are unable to predict what rates private carriers would charge if allowed to set prices freely based on market conditions.

Available data indicate that private firms competing with the Service for overnight, express deliveries currently offer contracted rates to large-volume customers approaching the Service's lower Priority Mail rates. For example, under a contract with the U.S. General Services Administration (GSA), which was in effect during the entire period covered by our review, FedEx charged federal departments and agencies $3.75 for letters (up to 8 ounces), and $3.99 for packages weighing from 1 to 3 pounds, for next-day delivery anywhere in the United States, including Alaska, Hawaii, and Puerto Rico. According to information obtained from GSA covering an 11-month period from February to December 1995, FedEx achieved monthly, on-time rates ranging from 91 to 97 percent for overnight shipments delivered by noon the next day, the standard in the contract, during 1995. Excluding the months when lapses in budgetary authority resulted in partial government shut-downs—November and December 1995—monthly on-time delivery rates ranged from 93 to 97 percent. For the same period, FedEx handled about 9.7 million shipments for government mailers subject to next-day noon or earlier delivery requirements.

In summary, the data we gathered and summarized in figures 4.1 through 4.3 indicate that (1) most mailers believed the Service's Priority Mail rates were as good or better than its competitors but the timeliness and dependability of Priority Mail service was not; (2) most nationwide private carriers would be ready and willing to deliver Priority Mail letters, particularly business-to-business mail, if the Statutes were changed; and (3) about one-fourth of the mailers we interviewed said they likely would divert Priority Mail letters to private carriers if the Statutes were changed to permit them to do so. Private carrier interest and delivery capacity, combined with mailers' willingness to shift some mail to private carriers, indicated the Service could be at high risk to lose significant portions of its Priority Mail volume if the Statutes were relaxed.

First-Class Letters Appear to Be at Less Risk Than Those in Other Classes

Although significant portions of all three letter mail classes and subclasses could be lost to private carriers, First-Class letters appear to be at less risk than Priority Mail or third-class letter mail. As indicated previously, nationwide express and parcel delivery carriers expressed little interest in delivering First-Class letter mail compared to the more lucrative overnight and deferred delivery markets.

Most (65 percent) of the alternate delivery firms we interviewed expressed some interest in delivering First-Class letters. Most also said that they were likely to pursue additional opportunities in the business-to-business and business-to-household segments of the mail market, which together account for nearly 90 percent of all First-Class letters.

Despite their apparent interest in delivering First-Class mail, most alternate delivery carriers currently lack the capacity to sort large quantities of addressed mail. If the Statutes were changed, those carriers may have a greater incentive to invest in the necessary capacity, but any significant increases could take several years to develop to the point where First-Class volumes could be affected materially.

Among the mailers we interviewed, only 2 of 12 (17 percent) said that they were somewhat or very likely to use private carriers to deliver First-Class mail, while 2 others said that they were as likely as unlikely to do so. Of the remaining eight mailers, six said that they were unlikely to use private carriers if the Statutes were changed, and two did not respond. In addition, including 2 newspaper associations, 11 of 14 mailers (79 percent) rated First-Class mail service and rates as good or better as competitors' service and rates.

An additional factor of importance to mailers was safeguarding personal or confidential information, which characterizes much of First-Class mail. Consequently, retaining the restrictions on nonpostal access to private mailboxes likely would help shield the Postal Service from private competition for delivery of First-Class letters. When asked generally if they would consider using private carriers to deliver protected mail if they were denied access to mailboxes, only one-third of the mailers we interviewed (4 of 12, or 33 percent) said they were likely to do so. However, one-half of the same mailers (6 of 12) said they were likely to use private carriers to deliver letter mail if they were allowed to place it in mailboxes.[35]

Mailers who do regular billing of residential customers see the restrictions on mailbox access as a reason to use the Postal Service. However, before the mailbox restrictions were imposed (in 1934), some utility companies were using mailboxes for private delivery of monthly billings. Where utility companies still regularly read residential water, gas, and electric meters, employees might deliver monthly bills again if the access restrictions were lifted. In addition, some newspaper officials with whom we spoke indicated that they would consider sending subscription statements via their own private carriers if mailbox restrictions were lifted.

[35]These results generally track the primary mail classes associated with mailers we interviewed. Of the 14 mailer organizations included in our structured interview survey, 5 were predominantly First-Class mailers, 2 were largely second-class mailers, 6 were principally third-class mailers, and 1 was largely a fourth-class mailer.

The mailbox restriction would be less likely to shield the Postal Service from competition for Priority Mail and heavyweight First-Class mail. Typically, this mail is delivered to businesses and often is too large to fit in residential mailboxes. In addition, national carriers often rely on a signature for delivery. In general, they did not see lack of mailbox access as a barrier to pursuing increases in their shares of these markets.

Some heavier weight First-Class mail could be exposed to a level of risk similar to Priority Mail if private firms could freely set prices to compete with the Service. For example, First-Class letters weighing between 8 ounces and 12 ounces have postage rates ranging from $1.81 to $2.62. First-Class mail in this weight range could be attractive for delivery by private carriers because they may be able to deliver some or most of it profitably at prices competitive with the Service's rates. However, this mail represented less than one-tenth of 1 percent of the Service's total volume in fiscal year 1995.

To summarize, the data we gathered indicate that most mailers rate First-Class postage rates and service as good or better than competitors' rates and service. If the Statutes were relaxed and mailbox access restrictions remained intact, mailers would not be likely to shift First-Class mail to private delivery. Most private carriers with existing, nationwide delivery capabilities expressed little interest in pursuing First-Class letter mail delivery. Carriers who operated local delivery networks indicated they would pursue some First-Class mail deliveries if the Statutes were relaxed or repealed.

Third-Class Advertising Letters at Low Risk

Although the alternate delivery industry has developed rapidly in recent years, the Service still dominates the advertising mail delivery market. As noted in chapter 3, the Service's share of the advertising delivery market, most of which is third-class mail, is about 96 percent. The Service's huge delivery infrastructure, high volume of third-class mail, and relatively low postage rates, which are structured to retain third-class mailers, reduce the likelihood that the Service would lose as great a percentage of third-class mail as Priority Mail over the next few years.

Alternate delivery firms saw third-class mail as their primary market niche. Nearly 90 percent of the alternate delivery firms we interviewed expressed an interest in pursuing additional third-class mail business. Specifically, 12 of 17 said they were very likely and 3 said they were somewhat likely to do so, while only 2 said they were unlikely to seek additional third-class business.

Similarly, 13 of 17 (76 percent) of the alternate delivery firms said that they were interested in pursuing additional business-to-household deliveries, without regard to mail class or subclass. According to the Postal Service, most third-class mail (about 73 percent) falls into the business-to-household market segment. Most alternate delivery firms (about 65 percent) also expressed an interest in adding more business-to-business deliveries if the Statutes were changed. Specifically, 11 of 17 said that they were somewhat or very likely do so, while 2 more said they were as likely as unlikely to do so. By contrast, only 3 of 17 alternate delivery firms said they were likely to pursue household-to-business deliveries, and 1 said it was as likely as unlikely to do so. (See fig. 4.2.)

Among the mailers we interviewed, about 42 percent (5 of 12) said that they would consider using private carriers for third-class mail delivery, 2 more said they were as likely as not to use private carriers, 3 said they were unlikely to mail privately, and 2 had no opinion (see fig. 4.1). Only 5 of 14 mailers we interviewed (36 percent) rated the timeliness and dependability of third-class mail delivery and third-class postage rates as good or better than competitors. (see fig. 4.3).

Recent actions taken by the principal third-class mailers' groups suggest that their members want greater freedom to select carriers to deliver advertising mail. As indicated previously, the Advertising Mail Marketing Association (AMMA), formerly known as the Third Class Mail Association, twice has participated in formal requests to suspend the Statutes for third-class mail. Most recently, in 1995, they were joined by the Direct Marketing Association (DMA). Collectively, AMMA and DMA members generate the vast majority of advertising mail volume.

While third-class mailers may be willing to divert more mail to alternate delivery carriers, current delivery capacity is limited. Most alternate delivery carriers lack the capacity to process and deliver large quantities of third-class mail. If the Statutes were changed, those carriers may have a greater incentive to invest in the necessary capacity, but any significant increases could take several years to develop to the point where the Service's third-class mail volumes could be affected materially. The Service, however, would appear to have a competitive advantage for third-class mail delivery in the foreseeable future, given the substantial volume of third-class mail that it handles and its worksharing arrangements with advertising mailers.

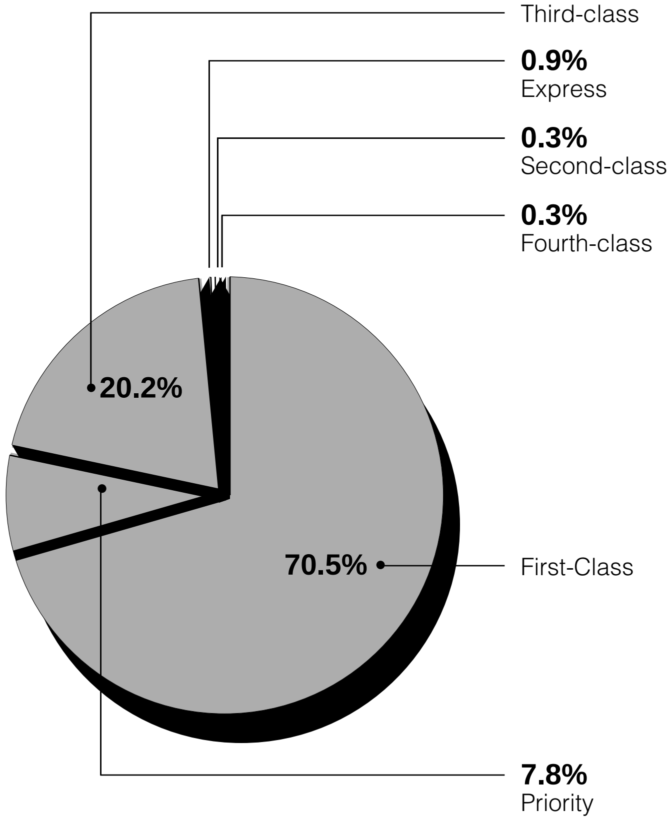
In summary, third-class mailers were not as satisfied with the postage rates they must pay or the timeliness and dependability of third-class mail delivery as with competitors' rates and delivery service. Many of these mailers said that they would likely divert third-class mail to private firms if the Statutes were relaxed. Similarly, most alternate delivery carriers said that they were likely to pursue additional third-class and business-to-household mail deliveries if the Statutes were relaxed. Because the collective capacity of the alternate delivery industry remains limited in comparison to the Postal Service, we believe the Service faces a lower risk of substantial third-class mail losses, compared to possible Priority Mail and First-Class mail losses.

The Service's Postage Rates Could Be Affected Most by First-Class Volume Losses

Although our analysis shows that Priority Mail likely would be at greatest risk to private delivery and third-class mail would be at low risk, the effects of a loss of such mail volume on postage rates would be less significant than if the Service experienced similar or smaller percentage losses of First-Class letters. This is because First-Class mail not only represents the largest single component of the mail stream in terms of volume and revenue, but also contributes substantially more than Priority Mail and third-class mail to the Service's institutional costs,[36] which tend to equate to overhead in the private sector. In fiscal year 1995, First-Class mail accounted for 71 percent of the Services' institutional costs, compared to 20 percent for third-class mail and 8 percent for Priority Mail. (See fig. 4.4)

[36]Contribution to institutional costs is a unique term of art in ratemaking used by PRC and the Service. It is defined as the revenue resulting from a product less the costs associated with that service—attributable costs. The extent of such contribution by each class and subclass of mail is important to the long-run financial viability of the Postal Service because such contributions help to cover the Service's basic infrastructure costs.

Figure 4.4: Comparison of Various Mail Classes Contribution to Institutional Costs in Fiscal Year 1995



Note: The terms contribution to institutional cost refer to the portion of each mail class' revenue that cover the Service's overhead cost, i.e., cost that is not attributable directly to a particular mail class.

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).

Under the 1970 Act, the revenue derived from all of the Service's mail deliveries and other revenue-producing activities, such as philatelic[37] and money order sales, must cover all of its operating costs, both in total and for each class and subclass of mail—the "break-even" requirement. To set postage rates, the Service assigns some of these costs directly to First-Class mail, Priority Mail, third-class mail, and other classes and subclasses. The difference between these costs and the related revenue is

[37]Phalatelic refers to stamp stock sold for the collection and study of postage and imprinted stamps.

available to cover the Service's "institutional" (or overhead) costs, which are costs not attributed to any class or subclass.

In theory, when the Service loses enough volume of a particular mail class or subclass, some portion or eventually all of the cost assigned to that mail class would be avoided altogether by the Service. In contrast, a decline in mail volume would not be expected to reduce institutional costs similarly. Thus, virtually all of the institutional costs previously covered by the lost mail volume must be redistributed.

The extent to which the Service's rates for different classes and subclasses of services would be affected by a decline in mail volume depends in part on the extent to which the Service would continue to incur the cost associated with that lost volume. Conceptually, a loss of mail in those classes and subclasses making the highest contribution to institutional costs would have the most adverse effect on the Service's rates. Conversely, a loss of mail with the lowest contribution to institutional costs would have the least adverse effect. As indicated above, compared to First-Class mail, Priority Mail and third-class mail represent a relatively small part—28 percent for the total of the latter two, compared to 71 percent for the former—of the Service's contribution to overhead.

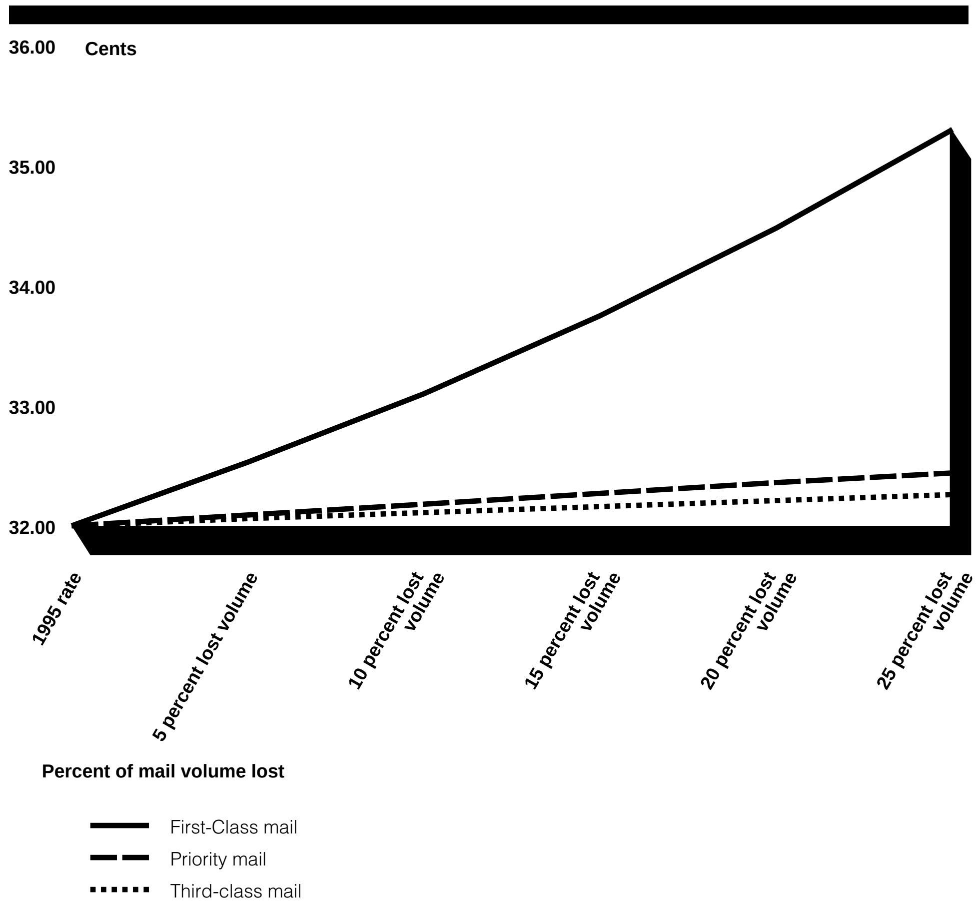
Mail Volume Losses Could Affect Postage Rates Very Differently

Our analysis showed that the greatest risk of financial impact on the Service would result from losses of First-Class mail. Losses of third-class mail and Priority Mail would have a much lesser effect. Because the effects of statutory changes on the Postal Service's mail volumes cannot be projected with precision for a variety of reasons, some of which are discussed beginning on page 71, we 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.

To provide an indication of the relative effects on postage rates, we show the estimated effects on the current basic letter rate of 32 cents (for a

First-Class letter weighing 1 ounce or less) assuming various percentages of First-Class, Priority, and third-class letter mail volume losses. We used the First-Class rate because of the Service's mandate in the 1970 Act to provide a uniform rate for at least one class of sealed envelopes, which the Service designated as First-Class letters. The effects of First-Class letter volume losses on the Service's basic letter mail rate would be far more significant than if the same percentage losses occurred for Priority Mail and third-class letters. (See fig. 4.5.)

Figure 4.5: Estimated Effects on the Basic Letter Rate of Various Mail Volume Losses Ranging From 5 Percent Up to 25 Percent in Fiscal Year 1995



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).

The estimated 3-cent increase from 32 cents to 35 cents depicted in figure 4.5 is not as large as some actual increases in the basic letter rate in past years. Since 1970, the cost of a First-Class stamp has increased 7 times, and the increase has ranged from 3 cents up to 4 cents. The most recent rate increase, which took effect in January 1995, was 3 cents.

Even though our analysis indicates that the basic letter rate might not significantly increase as a result of volume losses ranging up to 25 percent for Priority Mail and third-class mail pieces, the effects of letter mail volume losses on the estimated revenue per mail piece would differ among the Service's mail classes, subclasses, and selected categories, as table 4.2 shows.

Table 4.2: Estimated Effects on Average Revenue Per Piece for Mail Classes, Subclasses, and Selected Categories, Assuming 5 Percent and 25 Percent Mail Volume Losses in First-Class Mail, Priority Mail, and Third-Class Mail in Fiscal Year 1995

Class, subclass, or category	Average per piece revenue before "what if" losses	First-Class mail		Priority Mail		Third-class mail[a]	
		5% Loss	25% Loss	5% Loss	25% Loss	5% Loss	25% Loss
First-Class letter	$0.345	$0.351	$0.378	$0.346	$0.348	$0.346	$0.350
First-Class cards	.200	.202	.212	.201	.201	.201	.202
Priority	3.626	3.693	4.020	3.632	3.659	3.637	3.683
Express	12.921	12.998	13.374	12.928	12.958	12.933	12.986
Mailgram	1.809	1.810	1.818	1.809	1.809	1.809	1.810
Second-class	.227	.228	.234	.223	.228	.227	.228
Third-class single piece rate	1.594	1.596	1.609	1.594	1.595	1.594	1.596
Third-class bulk regular rate subject to Statutes	.172	.175	.186	.173	.173	.173	.174
Third-class bulk regular rate not subject to Statutes	.185	.187	.197	.185	.186	.185	.187
Fourth-class	1.854	1.862	1.902	1.855	1.868	1.855	1.861

Note: At our request, PRC 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.

[a]Third-class Bulk regular rate subject to the Statutes.

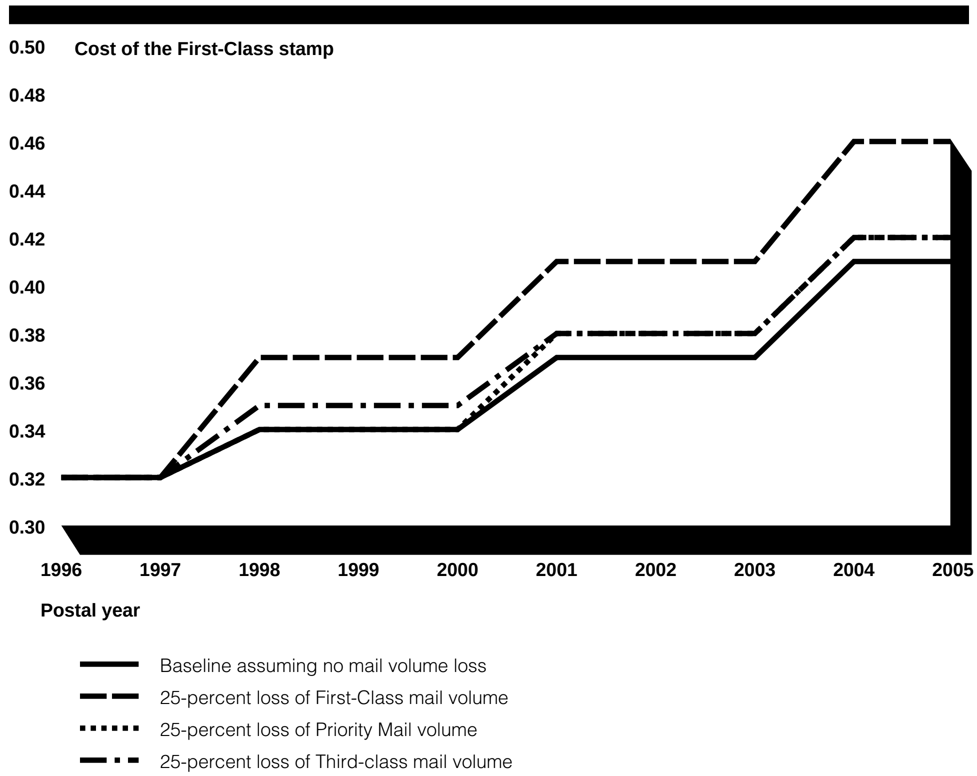
Source: Postal Service and Postal Rate Commission data used in setting postage rates effective January 1995 (Postage Rate and Fee Charges, 1994, Docket No. R94-1, Nov. 30, 1994).

Although we believe that our analysis is useful as an indicator of the possible effects on the Service's basic letter rate, the effects of any mail volume losses on other postage rates likely would differ significantly. The effects depend on the amount of assumed percentage volume losses among the affected letter mail classes and subclasses. For example, if

First-Class mail volumes had been 25 percent lower in fiscal year 1995, the Priority Mail rate would have increased by an average of 31 cents per piece (effective January 1995, the single piece rate for 2 pounds or less was $3). Using the same assumption, the rate for Express Mail (with a single-piece cost of $10.25 for 8 ounces or less as of January 1995) would have increased an average of 36 cents per piece.

Consistent with the data shown above, estimates provided by Price Waterhouse show that a 25-percent loss of First-Class mail volume could have a greater effect on the Service's basic letter mail rate than a 25-percent loss of either Priority Mail or third-class mail volumes. Specifically, the price of a First-Class stamp (for a 1-ounce or less letter) would need to be 41 cents in 2005 under the "baseline" estimate, while an assumed 25-percent First-Class mail volume loss would increase this price to 46 cents. In comparison, an assumed 25-percent loss of Priority or third-class mail would increase the price to 42 cents. (See fig. 4.6.)

Figure 4.6: Estimated Effects of 25-Percent Loss of First-Class, Priority, and Third-Class Mail Volume on the Basic Letter Mail Rate



Note: See appendix I for assumptions used in the Price Waterhouse model.

Source: Postal Service and Price Waterhouse model.

To provide a different estimate of the effects of a loss of Priority Mail even greater than 25 percent, we requested that Price Waterhouse use its model to estimate how the basic letter mail rates might change over a 10-year period if the Service lost 50 percent of its Priority Mail volume in 1 year. As table 4.3 shows, a 50-percent loss of Priority Mail volume would not have any effect on the estimated baseline rates during 1996-2005.

Table 4.3: Estimated Effects on the Basic Letter Rate of a 50-Percent Loss of Priority Mail in 1 Year

Postal year	Baseline assuming no mail volume loss (in dollars)	Assuming 50-percent loss of Priority Mail volume (in dollars)
1996	$ .32	$.32
1997	.32	.32
1998	.34	.34
1999	.34	.34
2000	.34	.34
2001	.37	.37
2002	.37	.37
2003	.37	.37
2004	.41	.41
2005	.41	.41

Source: Postal Service and Price Waterhouse model.

Competition for Second-Class Mail Could Increase If the Statutes Were Relaxed

The Service's second-class mail, consisting mainly of newspapers and periodicals, generally is not subject to the Private Express Statutes. However, if alternate delivery firms were allowed to compete with the Service for delivery of First-Class or third-class mail, many of these firms also might compete more aggressively for second-class mail delivery. In fiscal year 1995, the Postal Service reported that it delivered 10.2 billion pieces of second-class mail; although this mail generated revenues of almost $2 billion, it contributed less than 1 percent ($53.1 million) of institutional costs. Thus, a loss of 25 percent of second-class mail would have a minimal impact on the Service's overall revenue and postage rates, as compared to a similar loss of First-Class mail.

Revenue and Delivery Cost Effects Are Difficult to Estimate

The Service's revenue and its delivery costs could be affected differently among routes in the same part of the country if the Statutes were to be changed and the Service lost mail volume. This is because variations in customer mail density can affect revenue per delivered piece and cost per delivery.

The Postal Service believes, and the results of our review tend to support the Service's belief, that private firms would concentrate their investments and marketing strategies in those areas that would be the easiest to serve and most profitable. If this occurred, a change in the Statutes could have a different impact on the Service's net revenue in areas where revenue per delivery stop was higher and delivery cost per piece was lower than in areas where the revenue per stop was low and the delivery cost per piece was high. For example, if the Service lost mail volume in some high-volume geographic areas, carrier delivery costs could be unaffected after the volume decline if the carrier must travel the same delivery route and make the same number of stops along the route as before the loss. In this case, the Service would lose revenue to the extent of the volume loss but would not reduce its delivery costs.

Postal Service officials told us they had performed some analysis to better understand and measure how revenue and delivery costs might be affected in areas with different demographics as a result of mail volume losses. The analysis showed that a change in the Statutes could most affect those types of mail pieces, such as bank statements, bills, and retail advertisements, that were received in greater numbers by households with higher incomes. Households with the greatest incomes received three times as much mail as those with the smallest incomes, according to the Service's analysis. If the Service lost some mail now delivered to households with higher incomes, it is likely that it would still have to deliver some mail, but fewer pieces of mail, to those households each day. This could mean that the Service would collect less revenue from the mail delivered to these households but still incur about the same costs for the lesser amount of mail delivered to these same households.

Our analysis showed that the geographic concentration of alternate delivery firms specializing in distribution of third-class advertising matter tended to correlate highly with population density. However, we also identified some alternate delivery firms operating in more sparsely populated areas. We visited one such firm that had been in business since 1971 and, according to an independent third-party auditor, made regular, weekly deliveries to more than 98 percent of all households within its geographic market area.

Some empirical data exist to show that although private firms may focus on more profitable geographical areas, delivering mail in all but the most sparsely populated area could still be profitable. Postal Rate Commission staff reported the results (A Cost Comparison of Serving Rural and Urban Areas in the United States, dated April 1993) of analysis done on the Service's historical delivery costs for selected city and rural routes.[38] The study showed that the Service's average labor and vehicle costs per

[38]Some rural routes provide delivery service to suburban communities, and their delivery structure can be more like city routes than rural routes.

mailbox and the average cost per piece did not differ greatly between city routes and rural routes. The study also showed that rural mail routes were "profitable" for the Postal Service except for very sparsely populated areas that contained less than 2.9 mailboxes per mile.[39]

Although we believe that the above analyses by the Service and the Commission have provided interesting and useful information, sufficient data were not available to estimate how the Service's revenue, costs, and postage rates have been or might be affected as a result of changes in mail volumes in specific geographic areas, such as with varying customer mail densities. Therefore, to estimate financial effects relating to changes in the Statutes, we used the systemwide, average revenue and cost per mail piece for the various mail classes and subclasses that were used in the most recent ratemaking proceeding (Postal Rate Commission Docket No. R94-1), which resulted in new rates effective January 1995.[40] For ratemaking purposes, the Service does not differentiate its costs among geographic areas of the country but rather uses "systemwide" averages per piece for each class and subclass. (See app. I for further details on the methodologies we used for estimating the effects of mail volume losses on the Service's revenue, costs, and rates.)

Factors Other Than Statutory Changes Could Increase or Decrease the Service's Mail Volumes, Operating Costs, and Postage Rates

Although we have analyzed the risk to future mail volumes and rates assuming a change in the Statutes and a resulting increase in "direct" competition from private firms, a variety of other factors could affect the demand for mail services, operating costs, and postage rates. The effects of these factors on the Service are difficult to predict and measure; they involve unknowns regarding new communications technology—a form of "indirect" competition—and future decisions by the Service, its competitors, and postal customers.

In particular, the Service could be affected significantly in the future by losses of mail volume due to indirect competition, i.e., the diversion of correspondence and business transactions to electronic forms of communication. On the basis of the Service's analysis of its competition, these effects could be as great or greater than any impact that a change in the Private Express Statutes might have on the Service and its rates.

[39]In a more recent study, Cost and Returns from Delivery to Sparsely Settled Rural Areas, dated June 1995, economists John Haldi and Leonard Merewitz also found that most rural delivery routes were profitable.

[40]Systemwide averages for mail piece revenue and cost were developed for ratemaking purposes.

According to the Postal Service, six of its seven "product lines" involve some form of mail delivery. A seventh product line—retail services—involves nondelivery activities. Of the six delivery products, all but standard parcels are subject to competition from some form of electronic communication as well as private message and package delivery firms. As noted earlier, private carriers already dominate the expedited and parcel delivery markets. Table 4.4 summarizes the Service's assessment of the competition for the six delivery product lines and the amount of mail volume potentially at risk.

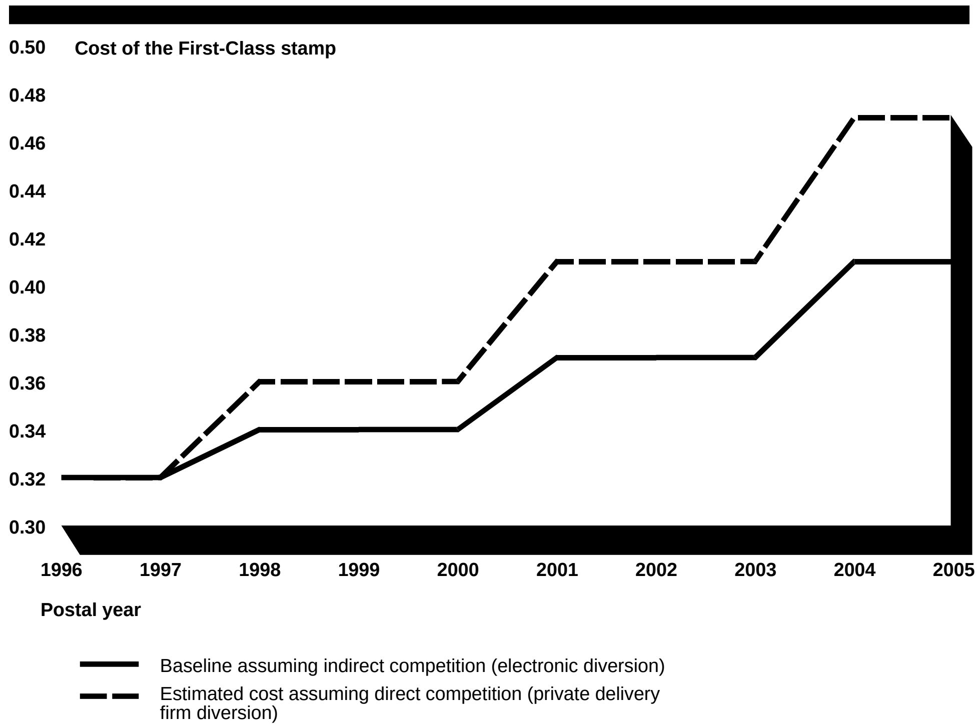
Table 4.4: Postal Service Assessment of Market Share and Competitive Risk

				Volume of pieces at risk	
	1994 Revenue (billions)	Percent of market share	Market share	Percent of current volume	Pieces (billions)
Correspondence and transactions	$24.5	54	Declining	11	9.00
Advertising mail	12.7	9	Growing	3	2.00
Priority and Express Mail	2.9	18	Declining	45	0.30
Parcels	2.0	15	Growing	None	None
Publications	1.7	(magazines) 21	Stable	Minimum	Minimum
International	1.4	28	Declining	10	0.15

Source: U.S. Postal Service.

At our request, Price Waterhouse used its model to estimate the effects on the basic letter rate over a 10-year period assuming the mail volume losses shown above were to occur from 1996 to 2005. According to the Price Waterhouse model, if the above estimates of possible mail volume losses occur, the current 32-cent First-Class stamp (1 ounce or less) would need to increase from an estimated baseline rate of 41 cents to 46 cents in 2005. (See fig. 4.7)

Figure 4.7: Estimated Effects of Possible Mail Volume Losses Estimated by the Postal Service Considering Direct and Indirect Competition



Note: See appendix I for assumptions used by the Price Waterhouse model.

Source: Postal Service and Price Waterhouse model.

The Service Plans to Compete More Aggressively

Recognizing the possibility that its future mail volumes could decline, the Service is taking steps to improve its competitiveness. Many of the Service's recent actions could have the effect of reducing the effects of greater competition from electronic communication and private delivery firms. Examples of several of these actions are described below.

- Under Postmaster General Marvin Runyon's leadership, the Service was restructured in 1992 and a major emphasis placed on improving customer service. The current national leadership includes recently recruited vice presidents from the private sector who head such functions as marketing, technology applications, facilities, finance, quality, and international business.
- At the Service's request, PRC recently recommended reclassification of most postage rates, in part to encourage mailers to do more barcoding of letter mail. This action, along with the Service's deployment of additional

automated mail barcode sorting equipment, is expected to reduce the Service's mail processing and delivery costs, thereby helping the Service to set and maintain more competitive postage rates for most of its mail classes and thereby maintain overall mail volume.

- The Service's business plans focus increased attention and resources on those markets that have strong growth potential and hold the promise of strong financial returns to the Service. For example, as we discussed in our recent report,[41] the international mail markets offer strong growth potential. The Service established a new international mail unit and introduced new international services to become more competitive in this arena. More recently, the Service began testing a new structure and process for improving its Priority Mail delivery performance.
- As detailed in our recent report,[42] the Service has a top-down, corporatewide initiative under way to focus all employees and management on improving service quality and customer satisfaction. If successful, this initiative could lead to improvements in the Service's on-time delivery performance and help it to compete more successfully with private delivery firms.

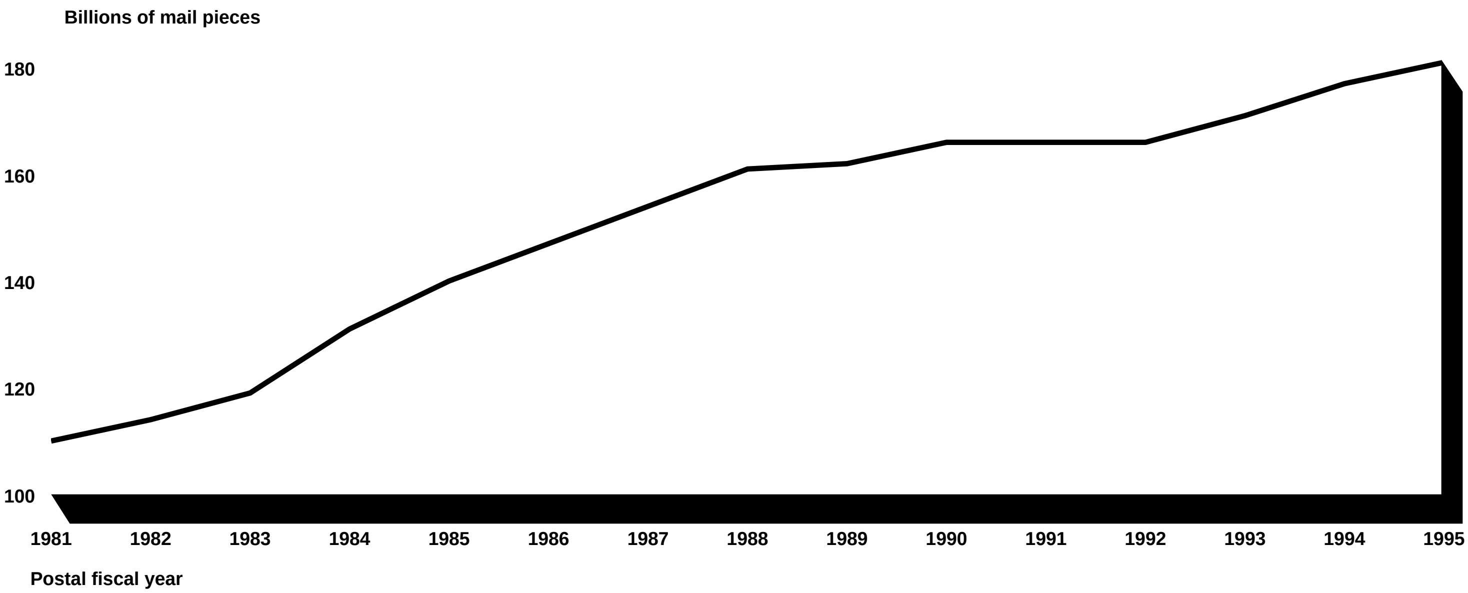
We cannot predict the outcome of these initiatives or changes in the Service's future mail volumes. Although the Service faces strong and perhaps unprecedented competition, historically it has experienced a steady growth in overall mail volume. This growth has occurred despite (1) the threats posed by new communications technology, which has replaced some traditional mail services; and (2) regulatory changes allowing private companies to compete for domestic overnight deliveries and all international mail services.

Although the Service has lost mail volume in certain classes, those losses have been offset by increases in other classes. For example, the Service reported losing 35 percent of its business-to-business First-Class mail since 1988 through diversion to electronic communications. Over this same period, however (from 1988 to 1995), overall mail volume grew more than 12 percent. For particular letter mail classes and subclasses, the average annual rate of growth was as follows: for Priority Mail, 14 percent; and for all First-Class mail (except Priority) and third-class mail, about 1.9 percent. As previously stated, the Service has lost most of its share of the expedited mail and package markets despite recent increases in Priority Mail and fourth-class mail volumes. Overall, however, mail volume has grown dramatically over the past 15 years, as shown in figure 4.8.

[41] U.S. Postal Service: Unresolved Issues in the International Market (GAO/GGD-96-51, March 11, 1996).

[42] U.S. Postal Service: New Focus on Improving Service Quality (GAO/GGD 96-30, Dec. 20, 1995).

Figure 4.8: Total Mail Volume During Fiscal Years 1981 Through 1995



Source: Postal Service data.

Various Factors Limit the Service's Competitiveness

The Postal Service recognizes that despite its efforts to become more competitive, it is constrained by various laws and regulations that limit its ability to compete successfully with private sector firms. In particular, the Service's ability to control its operating costs and competitively set postage rates is limited under the 1970 Act.

Under the 1970 Act, the Service must allocate costs and set rates in accordance with criteria that are tailored largely around its public service mission rather than those factors that tend to drive price and cost decisions in a competitive environment. Similarly, the 1970 Act contains criteria that the Service must follow in providing universal access to postal services through local post offices. The Service's competitors, on the other hand, have greater flexibility in determining when and where it is most efficient and profitable to offer their services.

Further, under the current ratemaking process, the Service believes that it lacks the flexibility to set or adjust postage rates quickly for services that must compete with those of private delivery firms. The Service and various study groups have said that the cycle time to implement new or adjusted rates can take up to 10 months and is a barrier to competition that has resulted in lost mail volume and revenue.

The Service also may be unable to adjust its work force, in the short run at least, to reduce operating costs commensurate with any future decline in mail volumes. The Service's approximately 600,000 craft employees who collect, sort, and deliver mail generally have job protection through union contracts.[43] This could complicate and delay significant reductions of the postal work force and labor costs to offset the effects of any quick downturn in mail volume.

However, the Service has been able to make some reductions in the career work force. For example, as part of a long-range automation plan initiated by former Postmaster General Anthony Frank, the Service reduced the career work force from about 774,000 to 718,000 career employees, or 8.5 percent, between May 1989 and August 1992 through reduced hiring. Postmaster General Runyon reduced the career work force by an additional 7.1 percent, from about 718,000 to 667,000 career employees, from August 1992 to April 1993 by offering employees monetary incentives for early retirement. In total, the Service reduced the career work force by almost 14 percent in about 4 years. Since April 1993, however, the Service's career work force has grown, by approximately 11 percent, to about 740,000 career employees in November 1995.

Overall, because of increased numbers of employees, higher wages and benefits, and growth in mail volumes, the Service has been unable to stop the growth of its labor costs. These costs accounted for the vast majority (more than 80 percent) of the Service's total operating expenses in 1970 and in 1995. 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.

[43]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.

Some Other Countries Have Narrowed Their Letter Mail Monopolies as Part of Overall Postal Reform

Many postal administrations around the world have mail monopolies to help meet universal letter delivery and other public service obligations, much like the U.S. Postal Service. However, unlike the Service, many of the postal administrations that we reviewed have made major legislative and policy changes in the past 15 years to give them greater freedom to operate like a private business. Some governments have narrowed their letter mail monopolies and one government, Sweden, has eliminated the letter mail monopoly. However, all postal administrations we reviewed continue to make certain postal services readily accessible to all citizens.

As part of our review, we obtained information on the postal monopolies in eight foreign countries: Australia, Canada, France, Germany, the Netherlands, New Zealand, Sweden, and the United Kingdom. Postal administrations in these eight countries were described in a recent Price Waterhouse report[44] as among the most "progressive postal administrations." Most of the eight have been reformed in the past 15 years to change their structure and operations and give them greater freedom from governmental control. The information in this report concerning the postal laws of other countries does not reflect our independent analysis of those laws; rather, it rests primarily on the views and analysis provided to us by officials of foreign postal administrations and other secondary sources.

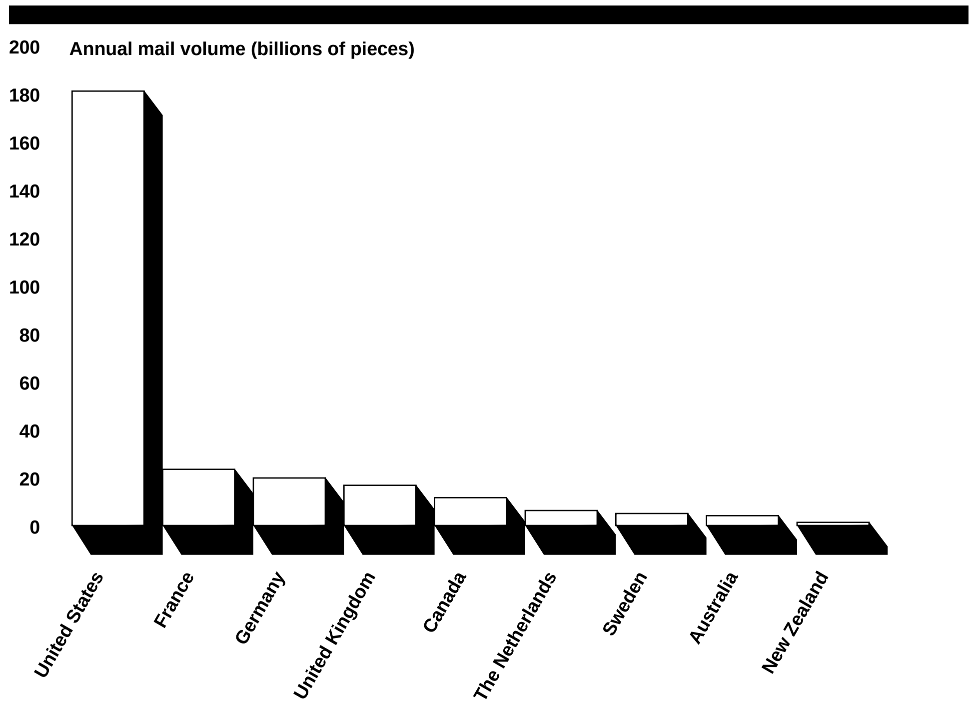
We previously reported[45] that the postal reform experiences of these countries are relevant to postal reform in the United States. The scope of our work did not include an evaluation of the effectiveness of postal reforms in these countries. As we have reported, detailed comparisons of the Postal Service's performance and specific practices with other postal administrations can be difficult because of size differences alone. For example, the Service is required to deliver to a larger geographic area than seven of the eight countries.[46] Further, the Service has at least seven times the mail volume and at least twice the number of employees as any of the other eight postal administrations. (See figs. 5.1 and 5.2.)

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

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

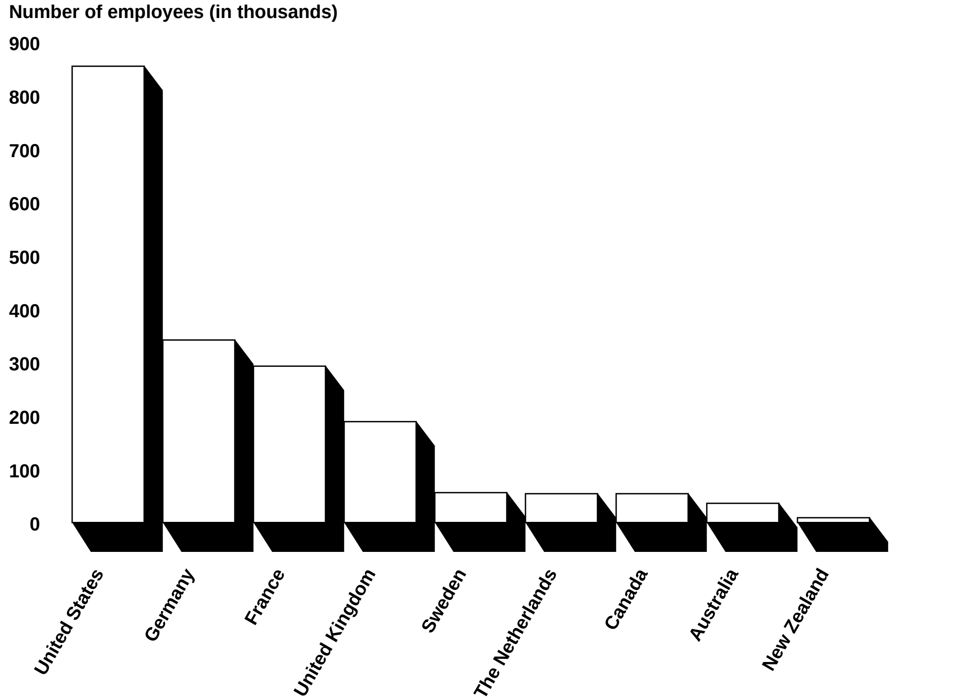
[46] Canada is slightly larger in size than the United States, and Australia is about eight-tenths the size of the United States.

Figure 5.1: Mail Volume in 1995 for U.S. Postal Service and Postal Services in Eight Other Countries



Source: U.S. Postal Service, foreign postal administrations.

Figure 5.2: Employment in 1995 for U.S. Postal Service and Postal Services in Eight Other Countries



Source: U.S. Postal Service, foreign postal administrations.

Postal Monopolies in Other Countries Are to Help Ensure Universal Service

The governments of many other countries provide some form of universal mail service and generally have restricted private delivery of certain mail to ensure the financial viability of postal administrations in those countries. By way of background, it may be helpful to summarize historical developments related to the development of foreign postal monopolies. In the mid-19th century, European governments developed "universal governmental postal service" to deliver mail to many homes and businesses and introduced uniform postal rates. These developments led to increased demand for international as well as domestic postal services. Since these governments had asserted a monopoly over postal service, there was no private mail system for international mail delivery. Instead, international mail was governed under bilateral agreements, which resulted in a complex set of rates calculated under different currencies, weights, and measures. To address this issue, postal administrations from 21 European nations and the United States agreed in 1874 to form a permanent international organization, the Universal Postal Union (UPU), to develop standard rules for exchanging international mail.

As discussed in our earlier report,[47] 189 countries (including the United States) participated in UPU in 1995. UPU now functions as a specialized agency of the United Nations and governs international postal services. Member countries have agreed to fulfill statutory universal service obligations on an international level by accepting mail from each other and delivering it to its final destination. In effect, each UPU member country has agreed to provide some form of universal mail delivery service for international mail to be delivered within their country.

In the eight countries we reviewed, the postal administrations provided certain services to their citizens at uniform rates before reform and continued to provide them following reform. However, the definition of universal mail service varies somewhat from country to country. Some of the countries provided the same level of service for urban and rural customers, while others had different service standards for urban and rural areas. For example, although Canada Post is required by law to maintain service that meets the needs of Canadian citizens, the service only needs to be similar for communities of the same size. Canadian citizens in very remote areas in the far north may receive mail delivery less frequently each week than those in some other areas of Canada.

Similarly, some citizens in rural areas of Australia and New Zealand receive mail delivery less often each week. In Australia, the frequency of rural delivery is based on a system agreed on between Australia Post and the government that takes into account the cost of delivery and special needs for educational materials and medical supplies. In New Zealand, a written agreement between New Zealand Post and the government specifies the proportion of delivery points that may receive delivery less frequently.

The legal basis of universal postal service also varies from country to country. Universal service requirements can be based on the country's constitution, statutes, written agreements between the postal administration and the government, policies established by the government minister who oversees the postal administration, or a combination of these. The way requirements are specified—and the degree of specificity—also varies from one country to another.

[47]See U.S. Postal Service: Unresolved Issues in the International Mail Market (GAO/GGD-96-51, March 11, 1996).

In some countries, changes in universal service practices have been controversial. For example, in New Zealand, New Zealand Post increased a long-standing rural delivery fee for service, paid by the addressee; this decision proved unpopular, and the fee was eliminated, effective April 1, 1995.

In Canada, changes in universal service have provoked debate and led in some cases to further changes in policy. After Canada Post was incorporated in 1981, it started to close and consolidate some rural post offices in order to increase the number of those that were privately operated through franchises. This policy was controversial and, in February 1994, the government minister overseeing Canada Post announced that rural post offices should no longer be closed.

Private Letter Delivery Restricted in Most Countries That We Reviewed

Governments in seven of eight countries that we reviewed imposed restrictions on the delivery of certain mail by private firms. One country (Sweden) recently eliminated its restrictions altogether, while several of the other seven countries had reduced the restrictions after reforming their postal administrations.

A variety of conditions led to the reform of postal administrations in other countries. However, according to the Price Waterhouse report mentioned above, a key reason for reform was an "increase in competition in the delivery and communications markets." Further, some other countries found direct enforcement of mail monopolies to be difficult and used other means to achieve compliance with legal restrictions on private mail delivery. For example, like the Postal Service, Canada's postal administration, Canada Post Corporation, primarily uses education and persuasion rather than legal action to get violators to comply with the Canadian law restricting the delivery of certain letter mail.

In many of the other eight countries, the mail monopoly exists for reasons similar to those supporting the U.S. mail monopoly. For example, Canada's mail monopoly has been justified on the grounds that the Canadian government was believed to be the only entity that could and would provide a postal service universal in scope. According to a recent study of Canada's postal system,[48] the private sector has been judged to be unwilling to make the large, expensive investment in infrastructure and commitments required to serve all areas, including outlying and

[48]From Robert M. Campbell's major study of the postal service in Canada, The Politics of The Post: Canada's Postal System from Public Service to Privatization, (Canada: Broadview Press, 1994), page 11.

low-density ones, with a full range of postal services at equitable prices. As a result of the monopoly, a single charge has been levied for basic nonlocal letter mail service in Canada since the nation was founded, regardless of the distance traveled or any complications associated with the route.[49] Although Canada reformed its postal laws in 1981, Canada Post officials said that the monopoly, or “exclusive privilege,” continues to be justified on both economic and social grounds.[50]

In contrast with the United States, none of the eight countries have laws that give their postal administrations exclusive access to the mailbox. However, there may be certain limitations to mailbox access in some countries. For example, in Canada, if Canada Post owns the mailbox, it is locked and only Canada Post has access to it. In some rural areas, there are mailboxes that are grouped together at various crossroads and are locked for security reasons. This also applies to some centralized mailboxes in secure apartment buildings. Advertisers cannot have access to apartments that do not allow door-to-door solicitation. By comparison, mailboxes owned by customers in Canada are accessible to anyone, including advertisers.

Definitions of Protected Letters in Other Countries Includes Measurable Characteristics

The postal monopoly is defined differently by individual postal administrations. However, a common practice among the eight countries we reviewed was to define the scope of the postal monopoly according to price, weight, urgency, or a combination of these factors. This is in contrast to the definition of a letter in this country, as defined by the Postal Service, where these measurable characteristics are not used except with regard to extremely urgent letters, for which the Service has suspended the Statutes.

In the other eight countries, the postal monopoly generally is defined in terms of minimum dollar or weight limits for items that may be delivered by private firms. These restrictions are generally contained in legislation.

[49]In 1968, Canada eliminated the local mail tariff that provided for mail originating and destinating in the same geographical area to be discounted by 1 cent.

[50]Canada Post told us that “From an economic perspective, it is believed that the provision of postal services exhibit material economies of scale and scope implying least cost production via a single producer but that competitive entry would occur in the absence of legal barriers . . . Such entry would erode the available economies of scale and scope and, hence, CPC is accorded a legislated exclusive privilege. Further, it is argued that the absence of competitive entry permits the use of simplified, highly averaged rates within exclusive privilege products that permit material savings in transaction cost and complexity.”

In some countries, the definition of the postal monopoly is clarified further by regulations.[51] (See table 5.1.)

Table 5.1: Key Price and Weight Limitations on the Postal Monopoly in Eight Foreign Postal Administrations

Country	Price limit[a]	Weight limit
Australia	4 times standard letter rate	250 grams (8.8 ounces)
Canada	3 times the 50 gram letter rate for items “of an urgent nature” currently $2.13 Canadian ($1.55 U.S.)	500 grams (1.1 pounds)
France	No price limit specified for monopoly	None specified for monopoly but 1 kilogram (2.2 pounds) is the de facto weight limit
Germany	10 times standard letter rate	100 grams for bulk mail and printed matter[b] (3.5 ounces)
The Netherlands (NLG)	Urgent mail[c]: 11.90 NLG ($7.21 U.S.) for domestic/European Community mail or 17.50 NLG ($10.61 U.S.) for mail to other countries[d]	500 grams (1.1 pounds)
New Zealand (NZ)	80 NZ cents ($0.55 U.S.)	200 grams (7.1 ounces)
Sweden	No monopoly	No monopoly
United Kingdom	1 £ ($1.56 U.S.)	None specified for monopoly

[a]Conversion to U.S. dollars is based on the July 31, 1996, rate of exchange.

[b]Competitors may obtain licenses to deliver these items above the weight limit.

[c]Mail services that are significantly faster than the standard express service currently provided by the Dutch postal administration offer better guarantees in that respect and provide the tracing of items during conveyance.

[d]Price threshold is not enforced at this time, pending new definition in line with anticipated European Community directive.

Source: Foreign postal administrations.

In the eight countries, common exclusions cover unaddressed advertising mail, intracompany mail, and outbound international mail. In particular, like the United States, all seven countries with a monopoly over letter mail excluded unaddressed advertising mail from their monopolies.

Sweden was the only country of the eight to have eliminated its mail monopoly altogether. Sweden’s postal monopoly ended on January 1, 1993, when full competition was allowed for letter mail.[52] The Swedish government, not the postal administration, has the obligation to provide universal mail service. The Swedish government currently contracts

[51]Court cases may also clarify the definition of the monopoly in some countries, such as France.

[52]Parcels were never included in the monopoly and the monopoly was never enforced regarding courier services, according to Sweden Post.

exclusively with Sweden Post to provide universal service.[53] The government can extend this arrangement in the future to other competitors that are able to provide the entire service or parts of universal service. According to Sweden Post, as no competitors currently fulfill this condition, an extension appears unlikely in the immediate future.[54]

The elimination of the postal monopoly in Sweden occurred in a different context from that in the United States, where an estimated 82 percent of the U.S. Postal Service's mail revenues are subject to the Private Express Statutes and implementing Service regulations. When the Swedish postal monopoly was in effect, it was much more narrowly construed. Sweden Post has estimated that before the monopoly was abolished, the revenues from business within the monopoly represented about 30 percent of Sweden Post's total revenues. The monopoly applied to the regular transmission, for a fee, of sealed letters and open items containing personalized information.

Postal Monopolies Have Been Narrowed in Some Countries After Postal Reform

Postal monopolies in several countries have been narrowed in the years following postal reform. Although many other countries were reviewing the scope of mail monopolies at the time of our review, we identified several countries that reduced the scope of their mail monopolies in the wake of postal reforms.

According to Robert Campbell's study of Canada Post, mentioned earlier, protection under the monopoly was weakened as a result of developments following passage of the 1981 law that established Canada Post and defined the postal monopoly. When a number of utility companies and municipalities in Ontario began delivering bills themselves, claiming they were not letters, Canada Post proposed a changed definition of "letter" in

[53]The basic scope of universal postal service in Sweden is defined in the Postal Services Act, which went into effect on March 1, 1994. The obligations of Sweden Post are specified in an agreement with the government that went into effect the same date. This agreement states that Sweden Post undertakes to provide a daily, nationwide mail and counter service.

The Swedish government also has the obligation to provide a payment service. Sweden Post provides a counter services network via post offices and rural mailmen and operates the Postal Giro system, which reportedly "is the normal way to pay a bill in Sweden." The government does not pay Sweden Post for providing universal mail service but does make a lump sum payment for a small number of post offices that are not commercially justified and are located in places where there are no other means of making payments. The subsidy covers less than half of the costs, according to Sweden Post.

[54]Sweden Post's "only competitor of some importance" in delivering mail, CityMail, "has so far not been a commercial success," according to Sweden Post. Sweden Post acquired a 75-percent share of CityMail in 1995 shortly before it went bankrupt in December. CityMail has been reconstituted and, with the support of new private capital, has been operating again in Stockholm. CityMail has announced plans to start operations again in additional parts of Stockholm as well as in Göteborg and Malmö.

July 1982. After considerable protest, Canada Post, businesses, and the government agreed on a mutually acceptable definition that was approved in May 1983. A letter was redefined to mean "one or more messages or information in any form." New exemptions covered transmission of electronic mail and allowed utility company employees to deliver bills made up on the spot. The monopoly was relaxed for minor financial documents such as interbank transactions.

Germany's postal monopoly was narrowed in January 1995, when licenses were granted to private companies to deliver bulk advertising and printed matter weighing more than 250 grams (about 8.8 ounces). This lifted the monopoly over advertisements and bulk mail, which opened to competition about one-quarter of the estimated DM 3 billion ($2 billion U.S.) market in bulk printed material. In January 1996, the weight limit for granting competitors licenses to deliver direct mail was lowered again, to more than 100 grams (about 3.5 ounces).

In New Zealand, the monopoly weight threshold was reduced from 500 grams (about 1.1 pounds) to 200 grams (about 7.1 ounces) in 1990, and the price threshold was reduced in phases from $1.25 NZ to 80 cents NZ by December 1991. In Australia, the monopoly price threshold was reduced in 1994 from 10 times the basic letter rate to 4 times the price, and the weight threshold was reduced from 500 grams to 250 grams. Other changes lifted the monopoly over outbound international mail, third-party carriage of intracompany mail, and carriage of bulk mail between cities.

The Postal Monopoly and Universal Service Were Being Reviewed in Other Countries

As competitive pressure continues to increase, further postal reform was being contemplated in some other countries, including additional steps to narrow or eliminate the postal monopoly. In 1995, various postal policy issues, including the postal monopoly and universal service, were under review in Australia, Canada, Germany, the Netherlands, and New Zealand.

In Australia, a review started in 1995 by Parliament was focused primarily on public service obligations (PSOs) and postal performance but also included an evaluation of the postal monopoly. The narrowing of the mail monopoly in 1994 generated concern in Parliament over Australia Post's ability to maintain services to rural and remote areas. Even before the changes to the postal monopoly became effective, the Country Mail Services Working Party (a subcommittee of the Australian government's Primary Industries and Energy Committee) reviewed the provision of Australia Post's PSOs. In February 1994, it recommended to the Minister for

Communications and the Arts, who oversees postal matters, that Australia Post's services to rural and remote communities should be protected through a review of PSOs once in the life of Parliament (i.e., every 3 years). This recommendation was accepted by the government.

As a result, the Minister requested that the Australian House of Representatives' Standing Committee on Transport, Communications and Infrastructure review rural and remote letter delivery services, including "the effect of any further reduction in reserved services" on Australia Post's performance of its public service obligations. In 1994 and 1995, 3.3 billion of the 4.1 billion pieces of mail were covered by the postal monopoly, accounting for 56 percent of Australia Post's revenues. The Committee also was reviewing the need for, extent, and cost of public service obligations, as well as Australia Post's ability to maintain or increase performance standards.

The Committee had not yet reported back to the Minister when a federal election was called. Australia Post told us the review was overtaken by the federal election, and thus a report had not been issued. The Post said "no legislation is expected" from the 1995 and 1996 review but added that a similar review process may take place in the future. In 1994, when the monopoly was narrowed, the Australian government had announced its intention to further review the monopoly in 1996 and 1997. According to Price Waterhouse, the outcome of future governmental review is uncertain but is likely to continue the "gradual erosion of the postal monopoly."

In Canada, a comprehensive review of Canada Post was to be completed by July 1996 on behalf of the Canadian government. The review was to consider whether Canada Post's letter mail monopoly should be "adjusted or discontinued." In 1995, the mail monopoly covered about half of the mail stream in Canada. The review was to also identify functions that Canada Post should continue to provided in the future, postal rate setting, the financial position of Canada Post, and the social costs of its "public policy functions," including how these costs should be allocated. In its submission to the review commission, Canada Post restated its commitment to universal service, defended its postal monopoly as necessary to support universal service, and responded to concerns about the fairness of its postal ratesetting.

The New Zealand government announced in November 1994 that it would introduce legislation to completely abolish the postal monopoly. Political pressures have held back legislative action, according to Price

Waterhouse. New Zealand Post told us ". . . it remains Government policy to introduce legislation to remove the monopoly."

Although no final decision has been made, New Zealand Post officials said last year that they had shaped their business plans to expect an open, competitive environment. New Zealand Post supported complete elimination of the postal monopoly. "Unfortunately the Government has not had the Parliamentary support to be able to effect this change," the Post said.

New Zealand Post did not believe that monopoly protection was necessary. The Post explained that: "Indeed, we believe that it represents a barrier to our achieving a truly market and customer focused positioning for our business. The 'monopoly' protection risks breeding a false sense of complacency and certainly impacts on public perceptions of our business. New Zealand Post has actively supported the Government Policy of completely deregulating the letter market."

The German postal administration has been implementing postal reform in stages, with privatization and deregulation planned for the near future. Under "Postreform I," started in 1989, separate entities were established for postal administration, postal banking, and telecommunications. Under "Postreform II," the German postal service was transformed on January 1, 1995, into a state-owned stock corporation. Under "Postreform III," further deregulation and privatization is planned. Deutsche Post declared in its 1994 annual report that "the company's privatization will be completed when it [partly] goes public in 1998."

Elimination of the postal monopoly in Germany has been under consideration. The German postal minister outlined legislation to begin deregulating the postal market in 1998 and introduce full competition in 2003. In its 1994 annual report, Deutsche Post stated that it "accepts the idea of a gradual and calculable limitation of its reserved areas" provided that (1) liberalization is in line with the postal policy of other European Community states, (2) competition is on a level playing field, and (3) there is "realistic moderation" based on the burden of universal service and payments related to pensions that stem from the previous personnel statute.

In the Netherlands, the government's Department of Transport had a review underway in early 1996 regarding the scope of universal service obligations and the postal monopoly. The review was expected to be completed in 1997, according to the Dutch postal administration, PTT Post. About 57 percent of PTT Post's sales in 1995 were derived from activities subject to competition. PTT Post strongly supported liberalization of postal monopoly restrictions, provided there was "national and international reciprocity and a level playing field for all suppliers of postal services."

Along with reform policies on universal service and postal monopolies, some countries have sold or are contemplating the transfer of some portion of ownership of postal administrations to the private sector. A majority share of the postal corporation in the Netherlands is owned by private parties.[55] Canada passed legislation in 1993 authorizing the sale of up to 10-percent ownership of Canada Post to its employees, but this had not been implemented as of August 1996. The Dutch postal administration remains the only partially privatized postal administration in Europe.[56]

In addition to these developments in individual countries, the European Community has been considering the adoption of common limits for the postal monopoly as part of an effort to achieve harmonization in postal policy among member nations.[57] The European Commission[58] began a comprehensive review of public policy towards postal services in 1988, which resulted in the 1992 publication of the "Green Paper."[59] In this document, the European Commission expressed the view that the universal postal service required throughout the Community (1) should be affordable to all, of good quality, and readily available; and (2) needed to be defined. Additionally, the Commission said that "this universal service objective can justify the establishment of a set of reserved services (subject to the decision of each Member State that this was necessary),

[55]In early 1996, the Dutch government owned a 45-percent share of Koninklijke PTT Nederland (KPN), the holding company of the Dutch postal administration. Its two divisions are PTT Post and PTT Telecom. KPN shares are traded on the London, Frankfurt, Amsterdam, and New York Stock exchanges.

[56]Singapore is the only other country where the postal administration has sold shares to the public, according to Price Waterhouse.

[57]The European Community (also generally known as the European Union) is a political and economic union of 15 European countries. Its member states are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

[58]The European Commission functions as the executive body of the European Community. The European Commission drafts and proposes European Community legislation and enforces the implementation of Community laws.

[59]Green Paper on the Development of the Single Market for Postal Services, Commission of the European Communities. Luxembourg: Office for Official Publications of the European Communities, June 1992.

which would help to ensure the financial viability of the universal service network."[60] It also said that "The list of services that could be included in this set of reserved services should be established at Community level."[61] In other words, the Commission supported a system that would allow member states to retain a limited postal monopoly, where necessary, to give postal administrations sufficient economic resources to guarantee universal service.

The Commission subsequently drafted a proposed directive[62] on common rules for the development of Community postal services and the improvement of quality of service, which could lead to changes in member countries. The directive declares that all countries in the European Community

> "shall ensure that users enjoy the right to a universal service involving the provision of a good-quality postal service for all users at all points on their territory at affordable prices. To that end, Member States shall take steps to ensure that the density of the points of contact, and of the points where mail is collected, take account of the needs of users."

The directive defines universal service as including "every working day, and not less than five days a week save in exceptional circumstances or geographical conditions: one collection from the clearance points, [and] one door-to-door delivery for every natural or legal person."[63]

The directive confirmed the member states' right to maintain a defined area of "reserved services" that generate financial resources for the maintenance and improvement of universal postal services. However, the directive proposes that:

> "To the extent necessary to ensure the maintenance of the universal service, the services which may be reserved to the universal [postal] service provider(s) in each Member State are the collection, sorting, transport, and delivery of items of domestic [as opposed to

[60]"Green Paper," Chapter 9, Introduction, page 233.

[61]"Green Paper," Chapter 9, 1.2, page 241.

[62]According to the European Commission, "A directive is a legislative instrument adopted at Community level which needs to be implemented by each member state into national law within a certain period of time." The Commission also said "the extent to which a directive which has not been implemented into national law within the required time frame 'automatically takes effect' in the law of the state concerned depends very much on the exact nature of the obligations at issue."

[63]According to the draft directive, "the universal service includes the following minimum facilities: the collection, transport and distribution of addressed mail items and addressed books, catalogues, newspapers and periodicals up to 2 kg [2.2 pounds] addressed postal packages up to 20 kg [22.0 pounds], [and]services for registered items and insured items. Universal service in the draft directive "covers both national and cross border services."

international] correspondence[64] whose price is less than five times the public tariff for an item of correspondence in the first weight step, provided that they weigh less than 350 grammes [12.3 ounces]...”

The European Commission has told us “It is important to note that the draft directive does not oblige member states to maintain any monopoly in their postal sector, but allows them to do so within the limits of the reserved services set out in the draft directive, to the extent necessary to ensure the maintenance of the universal service.”

The draft directive also provides that “direct mail” (mass advertising and marketing mail) and inbound international mail can also be reserved to the postal monopoly, “wherever their reservation is necessary for the financial equilibrium of the universal service provider(s)”, until December 31, 2000, at which time those services must be opened to competition unless the European Commission decides (by June 30, 1998) that the continuation of the monopoly in those areas is justified beyond that date. In addition, the draft directive provides that outbound international mail is excluded from the postal monopoly.

The draft directive also sets out minimum standards of quality of service (such as delivery times) to be met by the universal service providers in each member state. It provides for an overall review of the application of the directive to be conducted 3 years after it is adopted and at the latest by the first half of 2000. Discussion on the terms of the directive were taking place this year within the institutions of the European Community. In response to us, the European Commission said “it is hoped that the directive will be adopted in early 1997.”

Other Postal Administrations Were Preparing for Increased Competition

As a result of reform initiatives, some other postal administrations were set up to operate more competitively than the U.S. Postal Service. These postal administrations have been granted and were using greater commercial freedom to meet growing competition from electronic communications alternatives and private delivery firms. Among the actions that some have taken were downsizing the work force; increasing productivity; and taking initiatives to compete in electronic mail, facsimile, electronic bill payment, and other electronic communications services.

[64]“Item of correspondence” means a communication in written form on any kind of physical medium to be conveyed and delivered at the address indicated by the sender on the item itself or its wrapping. Books, catalogues, newspapers, and periodicals are not regarded as items of correspondence.

In addition, many foreign postal services have used their commercial freedom to acquire subsidiaries, participate in joint ventures, and contract out some functions that the U.S. Postal Service handles itself. For example, according to Price Waterhouse, a number of foreign postal services operated a majority of their post offices through private franchises.

Foreign postal administrations reported that they have used greater commercial freedom to become more competitive and provide more efficient and responsive postal services to the customer. At the same time, public concerns have surfaced in the wake of postal reform, notably regarding the continued provision of universal service, that have led to independent reviews and reexaminations of some foreign postal administrations. Despite these concerns, foreign postal administrations were continuing to make changes to enable them to respond to even stronger competition in the future.

For example, Canada Post President and Chief Executive Officer Georges Clermont said that Canada Post will undertake “a fundamental renewal of our corporation” through making “a dramatic shift from an operations-driven corporation to a customer-driven one.” He said:

> “Confronted with the reality of increasingly aggressive competition, higher service expectations from customers and an explosion of new communication technologies, Canada Post moved decisively to refocus its attention from its operations to its customers . . . we must face the fact that change is our only real constant.”[65]

Similarly, in Australia, where the postal monopoly was narrowed in December 1994, Australia Post Chairman Maurice Williams wrote:”...it is clear that direct and indirect competition will continue to increase,” and he said the Post will function in “an increasingly competitive environment where rapid technological changes are taking place.”[66]

In Sweden, the postal administration stated:

> “Sweden Post is in the midst of an ongoing—and accelerating—process of transformation. This is based on a progressive technological shift and a changed competitive situation. New information technology offers a path to a range of new opportunities for Sweden Post, but it also means that the Company will, by degrees, have to reshape its organization and working practices. Through a combination of new technology and a local presence—in the

[65]Annual Report 1994-1995 (Canada Post Corporation).

[66]Australia Post Annual Report 1995.

form of the post office and mail delivery networks—Sweden Post can continue to deliver messages, goods and payments for the foreseeable future."[67]

[67]Sweden Post 1994 Annual Report.

Postal Service Technical Comments and Our Evaluation

We requested comments on a draft of volumes I and II of this report from the Postal Service and the Postal Rate Commission. The Postal Service responded in a letter, with enclosure, dated August 29, 1996. Because the enclosure to the letter raised technical matters related to the content of volume II, the letter with the enclosure is reprinted in appendix II of volume II, and our comments on those technical matters are provided below. The letter is also reprinted in appendix I of volume I, and our comments on the letter itself are provided on pages 34-36 of volume I.

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.

In the letter portion of its comments, 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 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. Our detailed response to the Service's concerns in this regard is contained in volume I.

In the enclosure to its letter, the Postal Service reiterated its concern regarding estimates of financial conditions. Thus, we believe it is important for us to reiterate here that we did not attempt to make long-range forecasts and predict future financial effects of changing the Statues. 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.

Use of First-Class Stamp Price as a Proxy for Future Financial Position

The Service said that we used the price of a First-Class stamp as a proxy for its future financial position. It also said that this measure does not consider certain future revenue and expense requirements such as recovery of prior-year losses and funding of future retirement and workers' compensation costs. Further, the Service said that we should have considered what happens to the price of classes of mail other than First-Class because volume losses across all mail classes would require it to lay off at least 100,000 employees.

Our report presents a number of reasons why we chose the First-Class stamp price as the major, but not exclusive, focus for examining the price sensitivity of volume changes (e.g., see pp. 59, 61, and 64). A key consideration was that the First-Class stamp pays for about 70 percent of the Services overhead costs and, as such, reductions in its volume would substantially impact the revenue available to pay for these costs.

With regard to the completeness of our estimates, the baseline postage rates used by the Commission in our sensitivity analysis are the same rates that the Service put into effect in January 1995 for all classes and subclasses of mail. These rates include all of the revenue and expense items cited by the Service in its comments — including estimates for recovery of prior year losses, employee retirement, worker's compensation, and other revenue and expense requirements used by the Service and the Commission.

In addition, the Price Waterhouse estimates in our report include all of the same revenue and expense requirements used by the Commission, except for recovery of prior-year losses through higher future revenue and postage rates. According to Price Waterhouse, it had made estimates at different times for the Service that included and excluded the prior-year loss recovery. When a revenue requirement to recover such losses is included in the Price Waterhouse estimates, the baseline postage rates are higher and other postage rates derived from the model also are higher. In this regard, it should be noted that the effects of the Service's decisions to recover prior-year losses and provide for other such expenses through future rate increases would occur notwithstanding any change in the Statutes.

We considered not only the First-Class stamp price but all mail classes and postage rates. However, in light of the Service's concerns about how other classes of mail and the Service's total revenue might be affected, we included additional information in volume I (table 3) and volume II on the effects on various classes and subclasses of mail if the Service were to lose mail volume in the future.

With respect to the Service's comments that at least 100,000 employees would be laid off, we did not attempt to measure the impact of revenue losses on future postal employment. Such impact could be affected not only by possible mail volume losses but also by the time period over which such losses might be sustained and the Service's ability to adjust the postal work force commensurate with any reduced mail volumes and workload.

We agree, however, that a 25-percent loss of First-Class mail volume could have a significant impact on the Service.

Price Elasticity Considerations

The Service also said that our estimates did not include the effect of price changes on volume—commonly known as price elasticity. However, the estimates made by both the Commission and Price Waterhouse for our report include price elasticity for each mail class and subclass. In response to the Service's comments, we have further explained the elasticity rates used for our report, in appendix I, volume II.

The Service also said that if the Statutes are eliminated altogether and the Service and its competitors operate in a nonmonopoly environment, elasticity rates could change significantly. We agree with this basic proposition, but we did not make any assumptions about how or to what extent—if at all—Congress might change the Statutes or what elasticity rates might be in the future, both of which are unknown. For the purposes of our report, the Commission and Price Waterhouse used the same elasticity rates that were used by (1) the Service and the Commission for recent rate making purposes and (2) the Service and Price Waterhouse for financial forecasting purposes.

Postal Service Used Alternative Scenarios

In examining the assumptions underlying the estimates in our report, the Postal Service analyzed three scenarios. Its approach to developing scenarios was similar to ours. However, the Service used different baseline estimates, assumed much larger volume losses, and included higher elasticity rates than those used by the Commission and Price Waterhouse when examining possible changes in postage rates for our report. For example, the Service assumed that it would lose most presorted First-Class mail to private delivery firms by 2005. Because of these differences, the Service's estimates of the impact on the First-Class, 1-ounce postage rate, which are presented on pages 2 and 3 of the enclosure to its letter, are greater than the estimates in our report.

Postal Service Expressed Different Views on the Competitive Environment

The Postal Service also estimated more severe effects on its revenue than we did—particularly for Priority Mail. In essence it suggested that, because of the competitive environment, it could lose 85 percent of Priority Mail volume and calculated the effect of an immediate 85 percent loss. While we made no forecasts of future mail volume losses, it appears to us that the Service's forecast is a worse-case outlook for its Priority

Mail business. Even now, a major portion of Priority Mail is not protected by the Statutes and Priority Mail volume is growing.

The Service also presents its view about the behavior of presort and alternate delivery firms if the Statutes were removed or relaxed. Our assessment was that the relative risk of third-class mail volume loss is low compared to that of Priority and First-class Mail. Our assessment was based primarily on existing private sector capability as well as interviews with mailers and carriers. A key factor in our assessment was the Service's share of the expedited and advertising (third-class) mail markets, i.e., an estimated 15 percent of the former and 96 percent of the latter. We have no basis to comment on the Service's view that a substantial industry that combines mail preparation and delivery capability could quickly emerge if the Statutes are relaxed. Our report recognized that the Service believes this could occur, and we have revised volume I to further emphasize the Service's view of this possibility.

Description of Methods Used for Estimating Financial Effects of Mail Volume Losses

We used Postal Service and Postal Rate Commission estimates that were used for the January 1995 postage rate increases as the principal basis for the estimates in this report of how changes in future mail volumes might affect the Service's revenue, cost, and postage rates. We also worked with Price Waterhouse LLP to utilize a model developed under contract with the Postal Service to provide additional estimates of changes in the Service's revenue, cost, and rates in the event of future mail volume losses.

Postal Service and Postal Rate Commission Estimates

Under the Postal Reorganization Act of 1970, the Service is required to file a request for changes in rates of any services it provides to the Postal Rate Commission (PRC). As part of its request, the Service is to provide detailed information and data to explain its revenue needs, estimates of mail volumes, costs, prices, and rate design. PRC must hold public hearings and allow interested parties, including the Service's competitors, to present their views on proposed rate changes. At the completion of the case, PRC submits its recommendations to the Service's Board of Governors, which may adopt them in whole or in part.

To show how the Service's finances might have been affected from assumed percentage losses in volume, we used the estimated volume, cost, revenue, and rate data used by the Service, PRC, and other parties in the most recent postal rate case (R94-1). That data resulted in the 32-cent basic letter rate, which is the cost of a First-Class mail piece weighing up to 1 ounce, and rates for other mail that became effective in January 1995.

GAO Assumptions Used by the Postal Rate Commission

We arranged with the Postal Rate Commission to estimate for fiscal year 1995 the Service's revenue, cost, and postage rates assuming that First-Class, Priority, and third-class mail volumes were each reduced by 5 percent to 25 percent, in 5-percent increments, during that year. We used this range of percentage losses to help illustrate some possible financial effects on the Postal Service if its future letter mail volumes declined. The estimates do not represent predictions of the effect of relaxing the Private Express Statutes, because there are too many unknowns about the future decisions by the Service and its competitors and customers.

For the Postal Rate Commission estimates, costs attributed to First-Class Mail, Priority Mail, and third-class mail were reduced in direct proportion to the percentage reductions of volumes cited above. According to PRC, this assumption regarding changes in attributable cost was used in the R94-1 rate case. "Institutional" costs were not reduced overall but reallocated to classes and subclasses on the basis of the original institutional contribution percentages.

For its analysis, PRC assumed that the deficiency in institutional contribution was distributed to mail classes on the basis of their same share of contribution to institutional costs in the R94-1 rate case. The revenue deficiency was not distributed to nonprofit mail. This analysis assumed that the Postal Service would capture the cost savings in direct proportion to the revenue losses. The Commission used the same elasticity rates for its analysis as were used in the R94-1 rate case. It did not consider the second-generation volume loss that would result from the higher rates required to make up for the lost institutional cost contribution. Had the Commission included second generation volume loss, the basic First-Class letter rate would not have changed, using our volume loss estimates.

Postal Service and Price Waterhouse LLP Model

Price Waterhouse developed a strategic financial model in order to help the Postal Service evaluate the financial impact of large external and internal changes. The model was a complex computer program that translated "inputs," such as assumptions about electronic diversion, labor rates, productivity, mail volume changes, and other factors affecting costs, into "outputs" such as future revenues, costs, and estimated postal rates. The model provided financial projections for each year through 2005.

As part of its analysis, Price Waterhouse developed a baseline and alternative scenarios. Included in each scenario were estimates regarding the following:

- Mail volume changes, and the effects of electronic diversion and increased competition. According to Price Waterhouse, mail volume changes were based on early 1995 Postal Service volume growth forecasts, adjusted for anticipated future changes in postal rates using Postal Service demand equations and price elasticities.[68]
- Changes in postal employees' wages and benefits were based on the Employment Cost Index (ECI). For the baseline, it is assumed that wages would increase at ECI minus one half of a percentage point (ECI-.5) until 1998 and at full ECI through 2005. Other cost elements were escalated on the basis of the Consumer Price Index (CPI). The ECI and CPI forecasts were

[68]Demand equations and price elasticities are used to compute the degree to which mail volumes are sensitive to price increases.

based on Congressional Budget Office projections through 2004, the last year available, and assumed to be the same in 2004 and 2005.

- Changes in the Service's productivity were based on changes in volume.
- Changes in the composition, by craft, of the Service workforce were based on changes in the composition of mail handled by the Service.
- Changes in the number of delivery points were based on historical trends.

For the baseline scenario, assumptions in each of the above categories closely paralleled Postal Service and Postal Rate Commission assumptions, according to Price Waterhouse.

According to Price Waterhouse, the model also recognized the effects of the elasticity of demand.[69] For the baseline, elasticity estimates were generally consistent with estimates used in rate cases by the Service and PRC. Price Waterhouse said that it projected future labor requirements for the baseline using assumptions similar to those used in rate cases by the Service and PRC, i.e., (1) if mail volume increased, labor costs associated with that volume would increase proportionately; and (2) if mail volume decreased, labor costs associated with that volume would decrease proportionately.

The baseline estimates in the model also assumed that the Service would be required to break even throughout the 10-year future period. Thus, the Service could make a "profit" in some years, incur a loss in other years, and break even in the longer term. Further, it was assumed for the baseline estimates that the Service's regulatory environment would stay the same, and the Postal Rate Commission would continue to recommend postal rates. The estimates used in our report and based on the Price Waterhouse baseline scenario assumed a 3-year rate case cycle, with rate increases in 1998, 2001, and 2004. Selected results for the baseline scenario are shown in tables I.1, I.2, and I.3.

[69]Elasticity of demand is defined as the ratio of percentage change in quantity demanded to percentage change in price.

Table I.1: Price Waterhouse Baseline Scenario Estimates for Selected Postal Service Mail Volumes

	Estimated volume (millions of pieces)			
Year	First-Class[a]	Third-class[b]	Priority Mail	Total volume[c]
1996	97,847	73,245	717	185,724
1997	100,603	75,626	739	191,261
1998	102,993	78,287	760	196,685
1999	105,597	80,533	780	201,874
2000	108,188	82,760	799	207,012
2001	109,348	83,373	807	209,037
2002	111,852	85,526	826	213,978
2003	114,330	87,651	845	218,853
2004	115,169	88,007	851	220,258
2005	117,718	90,180	870	225,258

[a]Total of estimates for First-Class single piece, meter single piece, and bulk.

[b]Represents the total of estimates for third-class commercial and third-class nonprofit.

[c]Represents all classes of domestic and international mail, including First-Class, second-class, third-class, fourth-class, Priority, Express, and mailgrams.

Source: Price Waterhouse LLP.

Table I.2: Price Waterhouse Baseline Scenario Estimates for Postal Service Work Years, Labor Cost, and Mail Volumes

Year	Work years	Labor cost/ work year[a]	Volume/ work year[b] (pieces)
1996	857,169	$45,152	216,672
1997	873,885	46,467	218,863
1998	889,151	48,168	221,205
1999	904,749	49,899	223,127
2000	920,214	51,740	224,961
2001	927,180	53,698	225,454
2002	941,785	55,811	227,204
2003	956,323	57,901	228,848
2004	962,060	60,105	228,944
2005	977,475	62,392	230,449

[a]Incorporates assumptions for increases in labor rates, the mix of labor, and labor productivity.

[b]Incorporates estimates in volume (see table I.1).

Source: Price Waterhouse LLP.

Table I.3: Price Waterhouse Baseline Scenario Estimates for Postal Service Revenues and Costs

Year	Total revenue (millions)	Total cost (millions)	Annual surplus/ deficit[a] (millions)
1996	$57,251	$55,784	$1,467
1997	58,970	58,675	295
1998	63,637	61,886	1,751
1999	65,367	65,266	101
2000	66,998	68,849	–1,851
2001	74,187	72,010	2,177
2002	76,105	76,029	76
2003	77,914	80,166	–2,253
2004	86,450	83,794	2,657
2005	88,415	88,464	–49

[a]Surplus/deficit equals revenues minus costs.

Source: Price Waterhouse LLP.

GAO Assumptions Used by Price Waterhouse

At our request, Price Waterhouse provided us with its baseline estimates of future mail volumes, revenue, cost, and rates that it had developed for the Postal Service. Using its model, Price Waterhouse also provided us with the estimated effects on the baseline estimates under alternative assumptions, which we made, regarding Postal Service mail volumes. Price Waterhouse used these assumptions in the baseline scenario but, at our request, included "what if" assumptions regarding mail volume as follows.

- A loss of First-Class mail volume during 1996 through 2000 was assumed, at the rate of (1) 1 percent each year for a total 5-percent decrease; and (2) 5 percent each year for a total decrease of 25 percent, and similar rates of volume losses for third-class mail and Priority Mail. We used these percentages to provide examples of a range of possible effects of mail volume losses on the Service's revenue, cost, and rates.
- A 50-percent decrease in Priority Mail during 1996 was assumed. We used this estimate to supplement other estimates of the effects of Priority Mail volume losses, which showed that the loss of various percentages of Priority Mail ranging from 5 percent up to 25 percent did not significantly affect the basic First-Class, 1-ounce letter mail rate.

Price Waterhouse estimated changes in future mail volumes on the basis of the Postal Service's analysis of competitive threats from private firms and electronic communication. The Service estimated that First-Class mail volume could decline by 11 percent, third-class mail by 3 percent, Priority mail by 45 percent, and Express Mail by 45 percent; and fourth-class would remain unchanged.

We also arranged for Price Waterhouse to use its model to estimate how postage rates might change using different assumptions about changes in the Service's labor costs. The baseline estimates in the model assume that labor costs vary in direct proportion to changes in mail volume and revenue. For example, under this assumption, a 10-percent decrease in revenue within a particular mail class resulted in a 10-percent decrease in labor costs associated with that volume. It is uncertain whether the Service can reduce its labor cost at this rate, particularly if the volume loss occurs over a short time period. Further, the Postal Service and the Postal Rate Commission differed in their views on the extent to which labor costs could be and would be reduced with reductions in mail volumes.

The assumptions made regarding changes in the Service's labor costs as a result of mail volume changes could significantly influence the estimated effects of such changes on the Service's postage rates. Because of this, we arranged with Price Waterhouse to show how its baseline estimates would change using an assumption different from that described above regarding changes in future labor costs. This alternate assumption was that labor costs decreased at one-half the rate of the change in mail volume and revenue. For example, under this assumption, if First-Class mail volume and revenue dropped by 10 percent, the labor costs associated that volume would drop by only 5 percent. We arranged for these estimates, which are presented in volume I of this report, using a different assumption about labor costs only for the purpose of indicating the sensitivity of the Service's postage rates to these costs, which accounted for over 80 percent of the Service's total costs.

Finally, we arranged with Price Waterhouse to use its model to estimate the effects on the Services' postage rates assuming that specific categories, such as bulk rate First-Class letters, were to be lost and the Service would reduce, at different rates, its attributable cost associated with the lost mail volume.

Comments From the U.S. Postal Service

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

Impact on the Postal Service
of Changes in the Private Express Statutes -
Technical Evaluation of GAO's Study

Summary

We have several concerns with GAO's study. GAO has based its estimation of the financial impact on the Postal Service of relaxing or removing the Private Express Statutes by assuming selected mail volume reductions and then determining what the resulting price of a First-Class stamp would have to be in order for the Service to "break even." Although this approach may provide an inference about the Service's potential future finances, it presents a picture that leaves out important considerations, such as the Service's need to recoup past losses and anticipate future costs. We also think that the report has understated the Service's competitive environment. While the report offers no explicit recommendations or conclusions, the results presented leave the distinct impression that the Postal Service would not be materially impacted by a substantial relaxation of the Statutes. Our conclusion is just the opposite. Relaxing the Statutes would have a profoundly negative impact on the Postal Service, and more importantly, on our customers. Rapidly declining revenues would result in steep and unavoidable postage rate increases for our business and residential customers.

The Study

The purpose of the GAO report is to answer a Congressional request to "...analyze the *possible financial effects on the Service* if restrictions on private delivery of letters were to be changed" (italics added). Rather than perform a comprehensive analysis of the Postal Service's financial position in a post-Statutes environment, GAO has used as a proxy the price of a First-Class stamp. As a measure of our future financial condition, the First-Class stamp price--with increases based solely on volume changes--is not, by itself, sufficient. Among other things, it does not take into account the Service's mandate to recover prior years' losses and thereby eliminate our negative equity. It also fails to account for the Service's requirement to fund its deferred retirement and workers' compensation liabilities and related 'off balance-sheet' items.

Execution

The manner in which GAO has executed its study presents two concerns for us. First, we think that the study could have produced a more accurate picture if it had taken into consideration what happens to the price of other classes of mail given a price increase in First-Class. Second, and more fundamentally, GAO's future price estimates do not take into account the fact that when the Service has to increase its prices, customers respond by reducing how much they use the mail.

First-Class Stamp Price

The GAO analysis focuses on estimating the price of a First-Class stamp given various volume loss scenarios. These scenarios assume reductions of 5 percent, 10 percent, 15 percent, 20 percent, and 25 percent of First-Class Mail volume. GAO analyzed similar scenarios employing the same reductions in third-class mail and Priority Mail. GAO does not quantify what the changes in rates for other classes would be if the First-Class rate were to be increased to cover a 25 percent First-Class volume loss. Compounding this, GAO's analysis ignores that a relaxation of the Statutes would not only result in a substantial revenue loss for First-Class Mail, but would concurrently result in dramatic revenue losses for virtually all classes of mail. This would be caused first by the effects of competition, and second, by the effects of raising prices on all postal products.

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GAO's calculation of a 25 percent First-Class volume decline equates to a decrease in revenues of $8 billion. Costs are anticipated to decline proportionately with volume; a revenue reduction of $8 billion would result in a cost reduction approaching $5 billion. Since labor accounts for 80 percent of postal costs, a labor cost reduction of $4 billion is implied in this scenario. This equates to a workforce reduction of 10 percent to 15 percent--about 100,000 of the Service's employees. Furthermore, GAO's scenario results in an estimated 3-cent increase in the First-Class postage rate, plus undetermined increases in rates for all other mail classes, **and will require at least 100,000 employees being laid off**.

Price Elasticities

It is our position that GAO's study results would have been more in line with our estimates had GAO factored in a basic economic tenet that has always been present in our rate case calculations and the Postal Rate Commission's decisions--the effect upon volume of changes in price, commonly known as price elasticity. A price elasticity is a quantification of how much the volume demanded of a product varies given an increase or decrease in its price. The elasticity for all postal products is negative; we expect that people will buy more of a product if its price is reduced and less of a product if its price is increased. In using the Postal Rate Commission model, GAO assumes that there is no price elasticity for any of the Service's products. Simply put, GAO's analysis assumes that the Service can raise its prices indiscriminately to cover costs but that the increases in price will have no effect on mail volume. The 3-cent First-Class increase developed in GAO's 25 percent volume reduction scenario ignores the fact that when the price of First-Class Mail increases (plus undetermined increases in all other classes), the volume will decline further.

However, the critical point is not whether GAO should have used the Postal Rate Commission's elasticities. The critical point is that the current elasticities are not relevant to the analysis. These elasticities are calculated for price changes in a monopoly environment. Removal of the Statutes represents a paradigm shift from a monopoly to a non-monopoly environment. The change will entail prices becoming substantially more elastic; volume changes resulting from price changes will be dramatic compared to the changes observed in the current environment. The experience of AT&T in the long distance telecommunications market over the last two decades is probably quite instructive in this regard. Incorporating the relevant price elasticities into the calculations would more accurately reflect a non-monopoly, competitive environment.

Alternative Scenarios

To assess the validity of the assumptions underlying the estimates used in GAO's report, we analyzed three scenarios. For each scenario we estimated what rate changes would be required to meet the Board of Governors' equity restoration policy. The baseline scenario reflected current planning assumptions. The second scenario assumed a 25 percent loss in First-Class Mail volume taken exclusively out of the presorted mail subclass. The third scenario assumed a 25 percent loss in First-Class, Priority Mail and third-class.

To more realistically reflect the impact greater competition would have, we adjusted the price elasticities to mimic such an environment. We were conservative in that we did not assume First-Class and third-class became price elastic. Rather, we assumed that First-Class Mail's price elasticity approximated that of Priority Mail and that third-class mail had the same elasticity as its more competitive subclass, "carrier-route."

The results of our calculations differed from GAO's findings. The baseline scenario required rate increases in 1998, 2002, and 2005, leading to a 45-cent First-Class, first ounce rate. In the second scenario, with a volume loss of 25 percent of First-Class, rates in 2005 are 20 percent higher (i.e., a 54-cent First-Class rate). In the third scenario, with those volume losses spread to Priority Mail and

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third-class as well as First-Class, rates must rise four times to meet costs and are 54 percent higher than in the baseline (i.e., a 71-cent First-Class rate). Additionally, the multiple rate increases in the second and third scenarios do not provide the revenue required by the Postal Service to fund its deferred liabilities for employee pensions and workers' compensation costs.

Competitive Environment

The report briefly reviews competitors in the expedited delivery market and the growth of alternate delivery firms. Then GAO "judgmentally assessed the relative risk of the Service losing mail volume" and assigned risk values for volume loss and its financial impact (see page 30, Volume I).

GAO determined that the risk of loss of Priority Mail is high but that the financial impact of that loss would be low. The report states earlier that the major delivery companies have actively lobbied to obtain entry into the Priority Mail market. The report also states that the Service currently has about 15 percent of the 'expedited' market with the other five companies having about 85 percent. By virtue of the Statutes, the Service has an exclusive franchise to serve the entire Priority Mail letter market. Given the market's structure and competitors' eagerness to enter, it is entirely possible that the Service might lose a substantial portion of this market if it is opened to competition. It is even possible that eventually the Service's share could decline to 15 percent, its share of the unprotected segments. Putting that potential revenue loss into perspective, consider that the Service's net income in fiscal year 1995 was $1.77 billion. If the Service had lost 85 percent of its Priority Mail business, the reduction in net income would have been **$1.46 billion or about 82 percent** of its fiscal year 1995 income. If permitted, the entry of competitors into this market would be immediate and would have a devastating financial impact on the Service.

Furthermore, the report considers the risk of losing third-class letters to be low, but the evidence in the report is contradictory. GAO surveyed mailers and learned that many of them would likely divert some third-class mail to private firms if the Statutes were relaxed, and the current industry structure suggests that such a diversion could occur rapidly. There is a well-developed presort/mailing house industry which exists to take advantage of the Service's worksharing discounts. Although not currently substantial, there are also alternate delivery networks currently in place. It seems likely that if the barriers to entry were lowered by a relaxing of the Statutes, a substantial industry that combines mail preparation with delivery capability could quickly emerge.

3

Listing of GAO Structured Interview Participants

National Express and Parcel Carriers

Airborne Express, Seattle, Washington
DHL Airways, Redwood City, California
Federal Express, Memphis, Tennessee (in Washington, DC)
Roadway Package System, Pittsburgh, Pennsylvania
United Parcel Service, Atlanta, Georgia (in Washington, DC)

Alternate Delivery Firms

A&A Distribution, Inc., San Jose, California
Ad-Post Northwest, Inc., Burien, Washington
Advertisers Postal Service, Gaylord, Michigan
Alternate Postal Delivery, Inc., Grand Rapids, Michigan
Atlanta Journal and Constitution, Atlanta, Georgia
Distribution Systems of America, Inc., Brentwood, New York
H&H Advertising, Fort Worth, Texas
Houston Chronicle Express, Houston, Texas
Maxx Mail, New York, New York
Nationwide Alternate Delivery Alliance, Washington, DC
National Delivery Service, Princeton, New Jersey
The Philadelphia Inquirer, Philadelphia, Pennsylvania
Publishers Express, Inc., Marietta, Georgia
R-J Ad Service, Las Vegas, Nevada
Times Distribution, Inc., Kent, Washington

Mailer Organizations and Associations

Advertising Mail Marketing Association, Washington, DC
Alliance of Nonprofit Mailers, Washington, DC
Association of Priority Mail Users, McLean, Virginia
Council of Public Utility Mailers, Washington, DC
Direct Marketing Association, New York, New York and Washington, DC
Mail Advertising Service Association, Alexandria, Virginia
Mail Order Association of America, Washington, DC
National Federation of Nonprofits, Washington, DC
National Newspaper Association, Arlington, Virginia
National Postal Policy Council, Arlington, Virginia
Newspaper Association of America, Reston, Virginia
Parcel Shippers Association, Washington, DC
U.S. General Services Administration, Washington, DC (in Arlington, Virginia)

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