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 COMPTROLLER GENERAL OF THE UNITED STATES  
 WASHINGTON, D.C. 20548

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The Honorable Edward J. Derwinski  
 House of Representatives

Dear Mr. Derwinski:

In your letter which we received March 6, 1974, you asked us to define the public services provided by the Postal Service which a business-like organization might not provide or might modify considerably. You also requested that we estimate the cost of providing the public services so that the adequacy of the present public service appropriation could be judged.

You pointed out that the Postal Service is currently appropriated \$920 million annually for public service costs as provided in sections 101(b) and 2401(b)(1) of the Postal Reorganization Act (39 U.S.C. 101). As you noted, it has been alleged that the public service appropriation does not meet public service costs; hence, mail users are making up the fund deficiency through higher postage rates.

The Postal Reorganization Act does not identify individual public services whose costs would be reimbursable to the Service through the act's public service costs appropriation provisions (39 U.S.C. 2401). It does provide for reimbursing the Service for public service costs incurred when providing effective and regular postal service in communities where post offices may not be self-sustaining. Further, the public service cost policy established under 39 U.S.C. 101(b) provides that no small post office shall be closed solely for operating at a deficit. Thus, the Service's public service costs are not related to specific types of services but to deficits incurred by post offices which are not self-sustaining.

The Service's accounting system does not provide the detailed information that would be needed to identify any post offices operating at a deficit. To establish whether a post office operated at a loss (or gain), it would be necessary to determine how much of the postage revenue collected on each mail piece is allocable to operational costs, such as for collecting, sorting, transporting, and delivering, and match that assigned revenue to the cost of the operations. A system established to provide this information would be complicated and costly and would involve judgment factors which would be subject to question.

In view of the foregoing, it is impossible to define the public services provided by the Service which a business-like organization might not provide or might modify considerably. Further, the inability to identify public service costs prevents determining the adequacy of the public service appropriation.

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The Service had estimated that it incurs about \$1.1 billion of extra costs because provisions of law, union contracts, or regulations place constraints on the operating practices of certain postal activities. (See enclosure.) We have not attempted to verify this figure because, although we believe that there is little doubt that the Service could achieve substantial operating economies in the absence of any constraints, it does not have such freedom. The type of costs included in the estimate differs, for the most part, from the act's public-service-cost concept that such costs are those incurred in providing effective and regular postal service in rural areas, communities, and small towns where post offices may not be self-sustaining. Consequently, the Service's estimate of \$1.1 billion cannot be related to, nor used to measure, the adequacy of the annual public service appropriation.

#### THE SERVICE'S ESTIMATE

The Service estimated the savings it could achieve if it were not subject to regulatory or other constraints. The estimate is summarized below and presented in detail in the enclosure.

<u>Possible change</u>	<u>Savings</u> (millions)
Twice weekly, rather than 6-day, delivery service to remote areas	\$400
5-day, rather than 6-day, delivery service to all other patrons	250
Differential rates to attract and hold volume	200
Reduction in number of 3d- and 4th-class post offices	130
Other (11 items)	<u>105</u>
	<u>\$1,085</u>

The Service noted that many of these possible changes are presently prohibited by law, union contract, or regulation.

## NATURE OF PUBLIC SERVICE COSTS

An examination of past legislation shows that changes have occurred in the congressional intent regarding public service costs.

### Public Law 85-426

The Postal Policy Act of 1958 (Public Law 85-426, May 27, 1958) observed that (1) the postal establishment performed many functions and offered its facilities to many users on a basis which could only be justified as being in the national interest and (2) although the postal establishment was not designed to operate at a profit or to raise general funds, it would be unfair for any users, or class of users, to bear the burden of expenses incurred by reason of special rate consideration granted to or facilities provided for other users or to underwrite those expenses incurred in providing services of a nonpostal nature.

The act stated that services which the Congress considered to be public services should be assumed by the Federal Government. It identified these service costs as:

1. The total loss resulting from transmitting matter in the mails postage free or at reduced rates as provided by statute.
2. The loss resulting from operating the star route and third- and fourth-class post offices in providing prime and necessary service.
3. The loss from nonpostal services, such as the sale of documentary stamps.
4. The loss from special services, such as collect-on-delivery, insurance, special delivery, and money orders.
5. The added cost of transporting mail by foreign air carriers.

The Post Office Department's appropriation request for fiscal year 1959 included amounts applicable to each category of public service except for item 2 above. The Department did not submit a request for this category because its cost data did not provide a means to estimate the loss.

In a letter to the Chairman, Senate Committee on Appropriations, (B-136862, July 21, 1958), we said that the Department took the position that the loss (or gain) for the star-route system and third- and fourth-class post offices had never been developed by its Cost Ascertainment System and it knew of no practical and generally acceptable way by which such data could be developed. At the time we agreed that no information was available to provide a basis for estimating any loss attributable to the services. We recognized the estimating difficulties to be that:

"To determine such loss (or gain) it would be necessary to assign some portion of the postage collected on each item carried on a star route or handled in a third- or fourth-class post office and match that assigned revenue to the cost of the operation. A system established to provide this information would be complicated, costly, and would involve judgment allocation factors which would be subject to question."

In August 1958 the Senate Appropriations Committee deferred action on the proposed appropriation for fiscal year 1959 and the House Appropriations Committee, in acting on the second supplemental appropriation bill, rejected the Department's estimates of public service costs on the basis that there was no urgency to include such an appropriation in a supplemental bill.

The Department's appropriation request for fiscal year 1960 included \$172 million for estimated public service costs. The House Appropriations Committee rejected the estimates but the Senate Appropriations Committee recommended an appropriation of \$37.4 million--\$36.4 million for free and reduced rate mail and \$1 million for the excess rate paid to foreign air carriers. In conference the Senate action was accepted.

The Senate Committee commented as follows on the three public services for which appropriations were disallowed:

"Loss on star routes and small post offices

The Department has stated that no loss could be computed for these items. The committee goes further and believes that losses cannot be attributed to these integral parts of the postal system and designated as public services any more than losses can be attributed to truck transportation or the accounting and other staff services which are essential to successful operation of the whole postal system."

\* \* \* \*

"Loss on nonpostal services for other agencies

While the Department estimates it supplies \$16,500,000 worth of services to other agencies (mostly free rental in post office buildings), it acknowledges that it receives in return some \$40 million of free services from other Government agencies.

"The Committee concludes that it would be unfair to recognize only one side of the transactions."

\* \* \* \*

"Loss on special services

This represents the net difference between fees and expenses for special services such as collect-on-delivery, insured mail, special delivery, and money orders. These special services should be self-supporting to the extent practicable and the committee expects the Postmaster General to take necessary steps to bring fees and expenses into reasonable balance. When this is done there will be no residual loss to be supported by the general taxpayer as a public service."

Public Law 87-793

This act, dated October 11, 1962, amended the Postal Policy Act of 1958 and included the following amendments concerning the earlier act's public service sections.

- Recognized all in-county second-class mail as a public service and eligible for reduced rates of postage.
- Added rural routes to the public service category of star routes and third- and fourth-class post offices and provided for the cost of those public services to be 10 percent of the gross cost of operating star routes and third-class post offices and 20 percent of the cost of rural routes and fourth-class post offices.
- Changed the measurement of public service costs from the revenue-forgone concept to the total-loss concept, the difference between the total allocated cost incurred by the postal establishment in performing the public services and the total revenues received for such public services.

Public Law 91-375

The Postal Reorganization Act, enacted August 12, 1970, changed the approach to public service costs and the basis for funding these costs. Section 2401 (b)(1) of the act recognizes public service costs as those costs incurred by the Service in providing a maximum degree of effective and regular postal service in communities where post offices may not be self-sustaining. Further, in section 101(b) the act stipulates that no small post office shall be closed solely for operating at a deficit and states the specific congressional intent that effective postal services be insured to residents of both urban and rural communities.

To reimburse the Service for public service costs, section 2401(b)(1) authorized appropriations calculated as a percentage of the sum appropriated to the former Department for fiscal year 1971 operations. For each of fiscal years 1972 through 1979, 10 percent of the base amount (or \$920 million) was authorized and, for each fiscal year thereafter, the percentage is to decrease by 1 percent until 5 percent is reached for fiscal year 1984. Thereafter, the Service is to receive 5 percent of the base amount annually unless it finds that a lesser amount is required to operate the Service in accordance with the policies of title 39.

Certain free and penalty mail privileges, formerly considered public services, are retained under the Postal Reorganization Act, and the Service is reimbursed for mailings under these privileges by the revenue-forgone appropriation (39 U.S.C. 2401 (c)) or by the executive branch (39 U.S.C. 3206). Reduced-rate privileges continue under the act but are to be phased out over 8- or 16-year periods. However, while the reduced-rate structure remains in effect, the Service will receive an appropriation for these mail classes--and for authorized free mail--on the revenue-forgone basis (section 2401(c)). Thus, the Service's appropriation requests will include (1) an amount for public service costs based on a percentage of the 1971 appropriation amount and (2) an amount for revenue forgone on the free and reduced-rate mail. The terms public service and public service costs are associated only with postal service in areas where post offices are not deemed to be self-sustaining.

In hearings on April 23, 1970, before the Senate Committee on Post Office and Civil Service, the Chairman referred to an appropriation in an amount equal to 10 percent of postal costs as:

"\* \* \* the congressional allowance for the public interest sector, the rural areas, the 25,000 post offices out of the more than 30,000 that lose money each and every year because they do not have enough people using the service."

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The Chairman said also that the possibilities of adjusting that to a smaller percentage than 10 might be the subject of constant review as the new postal organization system got underway.

An appropriation based on a 10-percent calculation is also referred to in the Senate Committee's Report on Senate bill 3842 (Report No. 91-912, June 3, 1970). The report states:

"As a permanent ingredient of the new Postal Service, the committee recommends that in recognition of the losses incurred in maintaining post offices outside of metropolitan areas, the Congress shall appropriate annually a percentage of the annual operating costs of the Postal Service. \* \* \* the percentage appropriated shall be (1) 10 percent of the costs \* \* \* or (2) 10 percent of the amount appropriated to the Post Office Department for fiscal year 1971, other than capital improvement appropriations, whichever amount is the lesser. This subsidy would be based on the requirement that the Postal Service maintain high quality service in rural areas, small towns, and other places where post office and other governmental services provided by the Postal Service are not self-sustaining."

The Postal Reorganization Act (39 U.S.C. 3626(1)) provides that, for nonprofit, preferred-rate mailers, rates could not exceed the direct and indirect postal costs attributable to mail of such class, excluding all other costs of the Postal Service. A conference report referred to the excluded costs as "any portion of overhead or institutional costs." Sections 3626(1) and 2401(c) of the act, when considered together, make the Service indefinitely eligible to receive appropriations covering institutional costs related to servicing nonprofit, preferred-rate mail classes.

### CONCLUSION

Legislative history shows that "public service costs" evolved to encompass those added costs that the Postal Service incurs in providing rural areas with the same quality of service provided urban areas. It represents the difference between the cost of collecting, processing, and delivering mail in densely populated parts of the country and the cost of performing the same functions in sparsely populated areas.

The President's Commission on Postal Organization addressed the question of rural subsidies in its study. The contractor's report on this subject stated:

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"These rural services are part of the overall services provided by the Post Office and are of no greater 'public service' than the services provided for city dwellers. \* \* \* The rationale of the special treatment of rural costs focuses only on the revenues which originate in rural post offices through outgoing mail and disregards the fact that several times more mail is delivered to the rural areas than originates in rural areas."

This view is consistent with that of the Senate Appropriations Committee (p. 4) where the statement was made, in commenting on the losses incurred on star routes and small post offices, that:

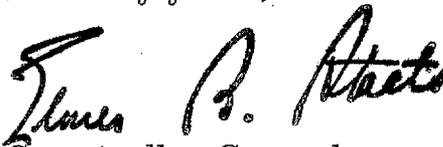
"The committee \* \* \* believes that losses cannot be attributed to these integral parts of the postal system and designated as public services any more than losses can be attributed to truck transportation or the accounting and other staff services which are essential to successful operation of the whole postal system."

Thus, the Commission and the Appropriations Committee are of the opinion that the value of the postal system to its users rests on its ability to reach the entire population. Consequently, the cost of moving mail to the rural population is a normal cost of system operation--not to be distinguished from any other cost.

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The Postal Service has reviewed the contents of this letter; it concurs with the facts presented. We do not plan to distribute this report further unless you agree or publicly announce its contents.

Sincerely yours,

  
Comptroller General  
of the United States

Enclosure

UNITED STATES POSTAL SERVICE  
ESTIMATED SAVINGS AVAILABLE  
IN THE ABSENCE OF OPERATING CONSTRAINTS

Practices requiring change in law, union contract, or regulation, or more than one of these, are marked with an \*.

Estimated extra costs are shown in terms of current cost levels. Increases in scale or inflation in future years will increase these amounts.

<u>Activity</u>	<u>USPS Practice</u>	<u>Unconstrained Practice</u>	<u>Extra Cost for USPS (millions)</u>
1. Delivery to remote places	Generally 6 days/wk	2 days *	\$ 400
2. All other delivery	6 days/wk	5 days	250
3. Small post offices	12, 220 3rd-class 6, 241 4th-class	6, 000 3rd-class 0 4th-class	68 62
4. Larger post offices	Maintain	Close or consolidate 2, 000 for economic reasons	30
5. Rates	Uniform for principal and other classes of mail	Provide differentials to attract and hold volume *	200
6. Parcel post	Restrictive size and weight limits	Uniform limits *	25
7. Air transportation	Restricted authority	Contract for services *	25
8. Law enforcement	Mail fraud, obscenity, master keys, pandering, advertising, firearms, lottery material, etc.	Less responsibility *	10
9. Employment practices	Civil Service requirements, Government social programs	Act as any good citizen *	20

## ENCLOSURE

<u>Activity</u>	<u>USPS Practice</u>	<u>Unconstrained Practice</u>	<u>Extra Cost for USPS (millions)</u>
10. Procurement	"Buy American," Small Business set-asides, etc., minority enterprise.	Act as any good citizen *	\$ 10
11. CAB sets rates for carriers	"Mail" rates higher	Tender shipments as any other good citizen *	10 <u>1/</u>
12. International mail	Payment generally on reciprocity basis	Negotiate reimbursement	5
13. Advances and collections for U.S. International air carriers	Provides services	Provide to extent a reasonable business practice *	--
14. Service to "offshore" locations	Serve all, generally on domestic basis	Lesser service *	2
15. Postal Rate Commission	Finances	Finance outside USPS budget *	<u>3</u>
			\$1, 120
Offset - taxes	Pays no local property taxes	Would pay	<u>(35)</u>
		Net	\$1, 085

1/ Net after application of No. 7.

GAO note: Schedule prepared by Postal Service in February 1974.