



Alaska Bypass: Beyond Its Original Purpose

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Executive Summary

Alaska is an enormous state with few roads and many remote communities accessible only by air. As the 20th century evolved, residents increasingly relied on the Postal Service to carry shipments of goods from urban areas like Anchorage and Fairbanks to these remote villages. Eventually, the Anchorage Mail Facility became overwhelmed by the volume, and it could take weeks for some packages to arrive. In 1972, the Alaska Bypass program was established as a mutually beneficial solution between the U.S. Postal Service and air carriers to remove bottlenecks and improve service.

Today, shippers in Anchorage and Fairbanks prepare shrink-wrapped pallets of goods, pay preferred ground Parcel Post rates, and deliver these full pallets directly to airlines, thus effectively “bypassing” the Postal Service entirely. In addition to the Bypass program, mail is also sent on the same planes to remote locations in Alaska. However, unlike mail, which is delivered only to the Post Office or its equivalent in remote locations, the airlines deliver Bypass orders directly to the recipient’s door. Due to the 1,000-pound minimum weight requirement for each order, the recipients in these remote locations are usually retail merchants. The Postal Service pays rates, set by the Department of Transportation (DOT), based on the costs incurred by the airlines. As a result, the Postal Service’s primary role in Alaska Bypass is to pay the bills, with little control over any other aspect of the program.

While the Alaska Bypass program started out as a thoughtful solution to a problem that once existed, much has changed since the early 1970’s, and Bypass has evolved beyond its original purpose. Based on the results of our research, we believe it is time for changes to this historic program.

Key Findings:

1. The Postal Service lost \$73 million on Alaska Bypass in FY 2010 and has little ability to lower its costs. Additionally, a number of obstacles, including the Consumer Price Index (CPI) price cap, constrain the Postal Service’s ability to increase its prices, making these losses likely to continue in the future.
2. Alaska Bypass is not mail. It is a freight service that includes items seemingly considered nonmailable anywhere else in the United States that are shipped on shrink-wrapped pallets that would be nonmailable themselves.
3. Alaska Bypass provides a higher level of service in Alaska than Priority Mail, but at average rates lower than Parcel Post.

4. Alaska Bypass currently supports five highly protected mainline airlines in Alaska and subsidizes the Alaska aviation industry.
5. The interests of the Postal Service were not protected during the development and evolution of Alaska Bypass, allowing its costs to be shifted to the Postal Service. By pushing all the costs of reaching remote residents to the Postal Service, Alaska Bypass removes an incentive for the state of Alaska to develop infrastructure to connect its rural residents. The State of Alaska's permanent fund is currently valued at almost \$40 billion and could theoretically be used to pay for the program or improve the state's ground and air infrastructure for the benefit of all Alaskans.
6. The rates the Postal Service pays the airlines are an artifact of a bygone era of price regulation that has been long abandoned domestically outside the State of Alaska. By simply passing the costs on to the Postal Service, the Bypass program removes incentives for the airlines to operate more efficiently or lower their costs.
7. The Rural Service Improvement Act of 2002, which attempted to modify Alaska Bypass to improve passenger air service, created overcapacity in passenger service. The proportion of empty seats on Bypass flights is now about double that in the continental United States. The Postal Service ends up paying for much of this excess capacity.
8. Contrary to general perception, the benefits of Alaska Bypass often seem to accrue more to a wide variety of commercial interests in Alaska than the remote village residents that many believe it is intended to serve.

In this paper we discuss a number of specific options designed to reduce the costs, increase the revenues, and make the Postal Service's responsibilities in Alaska more reasonable and consistent with its current role to provide universal service as it does in every other state.

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Alaska Bypass: Beyond Its Original Purpose

History

Rationale for Creating the Bypass System

Rural Alaskans have relied on the U.S. Postal Service since before statehood to deliver necessary supplies.¹ Alaska's vast area, geography, sparse population, and limited infrastructure have always presented a challenge to the Postal Service. The largest state in terms of geography, Alaska is one-fifth the size of the continental United States, but it is also one of the least populated states, with 710,000 residents.² Alaska has relatively few roads, leaving more than 180 of its rural communities accessible only by air year round.

Alaska faced unique challenges as its population grew in the late 1960s and early 1970s. By 1968, Alaska had four certified mainline air carriers, and each one had a regional monopoly and subcontracted routes for service to bush communities to small, independent carriers.³

As the rural population increased, so did the number of air passengers, amount of freight, and frequency of travel to rural areas. Bush package service became notoriously slow and unreliable as subcontractors struggled to keep up with demand. The Anchorage Main Post Office/General Mail Facility was inundated with packages, including food and other commodities intended for rural communities. Service suffered and perishable goods spoiled as the airlines gave passengers and their luggage priority on the subcontracted bush carriers.

The Alaska Bypass Program was introduced in 1972 as a mutually beneficial solution for easing Postal Service operational bottlenecks and providing more reliable rural package service. Figure 1 on the next page depicts more than 100 of the bush sites and air hubs currently in the Bypass Program. This intra-Alaska system allows businesses in Anchorage and Fairbanks to ship directly to rural customers (usually retail merchants) using a hub-and-spoke system. Major airline carriers take food items and other cargo on pallets to hub airports.⁴ Smaller airline companies or independent pilots then break down these pallets and deliver to remote bush sites. The goods "bypass" the Postal Service entirely, saving it handling costs and time. Goods shipped via Bypass must be ordered from authorized shippers in minimum quantities of 1,000 pounds, and Bypass

¹ Prior to the 1970 Postal Reorganization Act, the Postal Service was known as the Post Office Department, a Cabinet-level department within the federal government.

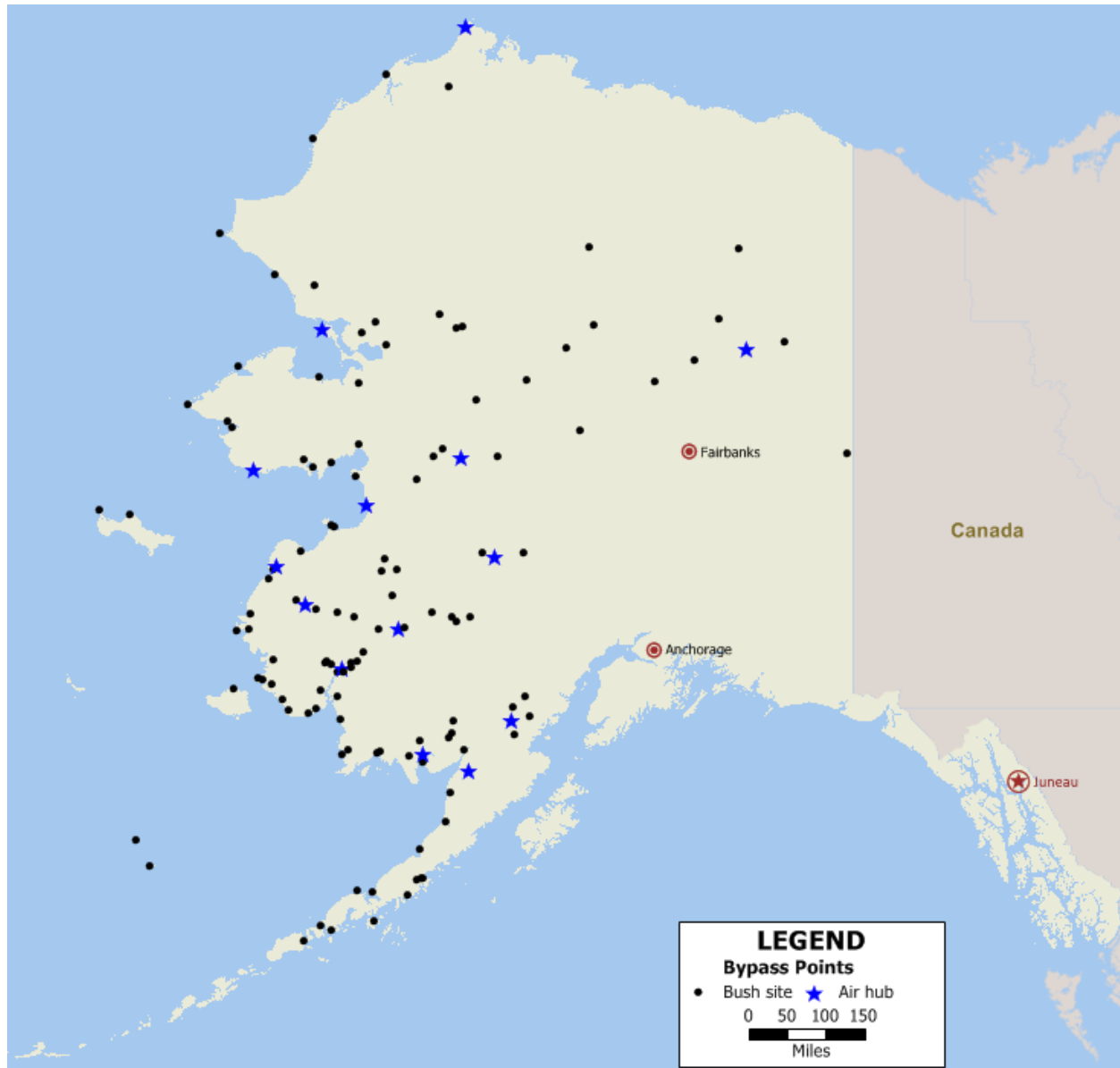
² U.S. Census Bureau, "Alaska Quick Facts from the US Census Bureau," <http://quickfacts.census.gov/qfd/states/02000.html>.

³ Bush communities is a common name for those remote communities accessible only by air.

⁴ Bypass carriers are classified as mainline or bush carriers. Mainline carriers, which serve the regional hubs, have a capacity of more than 7,500 pounds. There are currently five certified mainline carriers: Alaska Airlines, ERA Alaska, Everts Air Cargo, Northern Air Cargo, and Lynden Air Cargo (freight only). Bush carriers, of which there are 37 approved, are authorized to carry up to 7,500 pounds.

pallets generally travel the same routes and in the same planes as mail. See Appendix A for a summary of how the Alaska Bypass ordering process functions.⁵

Figure 1: Map of Alaska Bypass Sites



Note: Some points overlap. Map only depicts air sites. Some Alaska Bypass moves by surface transportation.

Source: OIG analysis of Postal Service airstop data.

⁵ For program details, see U.S. Postal Service Handbook PO-508, *Intra-Alaska Mail Service by Air: Instructions for Certificated Carriers and Bypass Shippers*, January 2000, <http://about.usps.com/handbooks/po508/welcome.htm>.

Evolution of Bypass

The creation of the Bypass program coincided with the move toward airline deregulation in the United States during the 1970s, and this shift in aviation policy drastically affected its development. Prior to deregulation, the airlines that flew commercial routes in the United States were highly regulated by the Civil Aeronautics Board (CAB), which assigned routes to specific carriers, limited market entry, and set ticket prices.⁶ Opponents of deregulation worried that airline service to rural communities with few passengers would be cut, so subsidy programs like Essential Air Service (EAS) were created to maintain rural air service. Though originally intended to end after 10 years, the EAS still operates today, including at 45 sites in rural Alaska.⁷

Aside from direct subsidies, another way the federal government financially supported passenger air travel during airline regulation was by paying airlines to carry mail. For example, the Civil Aeronautics Act authorized the CAB to set the rates the Postal Service would pay for airmail throughout the country, a program known as Mail Pay, which facilitated service to rural communities by ensuring that air carriers would be reimbursed on these routes. As the CAB was about to sunset in 1984, Congress passed a law (Public Law 98-443) preventing the Postal Service from directly contracting for air service in the State of Alaska. The authority to set rates the Postal Service would pay to air carriers in Alaska was transferred to the Department of Transportation (DOT), along with a number of other responsibilities previously held by the CAB relating to consumer protection.⁸ This law effectively served to maintain the structure of airline regulation exclusively in Alaska, with certified carriers, government set rates, and a Mail Pay-like system. Please see Appendix B for a timeline of air service in Alaska.

This DOT's authority was intended to transfer to the Postal Service in 1989 to allow rates to be set by "negotiation and competitive bidding", according to the 1984 law.⁹ But the DOT's authority was extended by Public Law 100-238 in 1988 and it eventually became permanent.¹⁰ Further sections were added establishing the extensive regulations that determine how Bypass carriers are selected. The provisions required that carriers maintain a minimum number of flights to each hub. They also stated that before the Postal Service could make network changes, such as reclassifying a bush site to a hub where lower-cost mainline airlines could operate, it must conduct extensive consultations with Alaskan officials and give the public 12 months' notice.¹¹ This extensive public hearing process makes it difficult for the Postal Service to pursue needed network improvements as it gives opponents wide leverage to fight proposals.

⁶ Roger Mola, "Economic Regulation of Airlines," U.S. Centennial of Flight Commission, http://www.centennialofflight.gov/essay/Government_Role/Econ_Reg/POL16.htm.

⁷ U.S. Department of Transportation Office of Aviation Analysis, "What Is Essential Air Service?" April 1, 2009, <http://ostpxweb.dot.gov/aviation/rural/easwhat.pdf>, p. 1.

⁸ Public Law 98-443, Secs. 3(f)(3) and 8(g)(4)(F), October 4, 1984.

⁹ Public Law 98-443, Sec. 3(f)(3), October 4, 1984.

¹⁰ Public Law 100-238, Sec. 137 (1), January 8, 1988.

¹¹ Ibid.

Rural Service Improvement Act of 2002

As a result of the changes described above, air carriers began eliminating passenger service in favor of carrying only profitable Bypass program pallets paid for by the Postal Service. In response, Congress introduced the Rural Service Improvement Act of 2002 (RSIA).¹² The act instituted an “equitable tender” policy for mainline carriers, giving priority to those airlines that also carried passengers and ensuring that airlines with more capacity were not carrying additional Bypass pallets at the expense of passenger service. The law also established significant hurdles for new market entrants. Notably, any carrier seeking equitable tender on an existing mainline route must maintain at least 75 percent of the number of passenger seats of the largest carrier already operating on that route for 6 months before being allowed to receive Bypass freight.¹³

Senator Ted Stevens, the late Alaskan senator who championed RSIA, described the Alaska Bypass System in the Congressional findings section of RSIA as a four-legged stool, designed to

1. Provide the most affordable means of delivering food and everyday necessities to these rural and isolated communities,
2. Establish a system whereby the Postal Service can meet its obligations to deliver mail to every house and business in America,
3. Support affordable and reliable passenger service, and
4. Support affordable and reliable nonmail freight service.¹⁴

Stevens’s statement made clear that the objectives of the Bypass Program had expanded well beyond the original purpose to prevent bottlenecks at Postal Service processing facilities and improve package service to rural Alaska. While the RSIA had many noble goals, such expansion highlighted the growing question as to whether the Bypass Program has come to have a new purpose and if this purpose is consistent with the goals of an independent, self-supporting Postal Service.

Over the course of its history, the Postal Service has had an important role in helping to build the nation’s transportation infrastructure, from waterways to rail to air travel.¹⁵ Often, these efforts came at some expense to the Postal Service. It began to lose money on mail transportation as soon as authority to negotiate prices with air carriers

¹² Public Law 107-206, Sec. 3002, August 2, 2002. Many other improvements have been made along the way to fix the most egregious problems with Alaska Bypass. For example, industrial construction materials may no longer be shipped via Alaska Bypass.

¹³ 39 USC 5402 (g)(1), (h)(1) and (h)(2). There are similar restrictions for 121 and 135 bush carriers as well.

¹⁴ Public Law 107-206, Sec. 3002, August 2, 2002.

¹⁵ For information on the Postal Service’s role in promoting transportation infrastructure, see U.S. Postal Service Publication 100, *The United States Postal Service: An American History 1775-2006*, May 2007, <http://about.usps.com/publications/pub100/welcome.htm>.

was taken over by the Civil Aviation Administration (CAA) in 1938.¹⁶ These types of losses were common when the Post Office Department was part of the Cabinet and Congress appropriated its funds. As part of the federal government, the Post Office Department supported programs seen as essential to the nation, such as protecting rural citizens, who might otherwise have faced severely restricted air service or exorbitant prices when the airline industry was deregulated.

But the Postal Service's role changed in 1971 with the enactment of the Postal Reorganization Act, which replaced the Cabinet-level Post Office Department with the independent Postal Service.¹⁷ The Act directed the Postal Service to be self-supporting and operate like a business. Accordingly, it raises revenue through the sale of postage and does not receive appropriations for regular operating expenses.¹⁸ Given this change, absorbing the costs of expensive programs seemingly outside of the Universal Service Obligation no longer appears appropriate, as mail customers often now cover those costs and would likely consider such subsidies problematic.

Program Review and Assessment

Alaska Bypass is often called Alaska Bypass Mail, but the program does not deliver mail. Alaska Bypass ships goods and commodities that resemble freight or cargo,¹⁹ and some of these commodities do not appear to be mailable.²⁰ The Alaska Bypass program allows commodities in bulk shipments destined for rural Alaska to “bypass” postal facilities and be tendered directly to air carriers, who deliver them to the doors of merchants serving remote residents. While Alaska Bypass pays preferred Parcel Post rates, it is not Parcel Post. Table 1 on the next page provides an operational comparison between Parcel Post and Alaska Bypass.

¹⁶ R.M. Kane, “The Air Carrier Industry and Federal Legislation,” *Air Transportation* (Dubuque, IA: Kendall Hunt Publishing, 2003) pp. 99-142.





¹⁷ Public Law 91-375, August 12, 1970.

¹⁸ The Postal Accountability and Enhancement Act of 2006 (Public Law 109-435) made further changes, which allowed the Postal Service to retain earnings and were intended to provide it greater flexibility in pricing its products.

¹⁹ See Appendix C for a picture of an Alaska Bypass pallet.

²⁰ Domestic Mail Manual (DMM) Chapter 6 states that fruits and vegetables are not mailable, but Bypass shippers told us such items are sometimes sent via Bypass. The DMM also places specific restrictions on the mailing of liquids that are apparently not enforced in the Bypass program. Parcel Post has a maximum weight of 70 pounds and a maximum length plus girth of 130 inches — neither of which are directly enforced for the Bypass program. Parcel Post has “balloon” prices and “oversized” surcharges that are, again, not directly enforced for the Bypass program. The Postal Service does restrict some items such as Hazmats on Alaska Bypass. As such, products like bleach are delivered to retail merchants via other means. DMM Section 601, “Mailability,” <http://pe.usps.com/text/dmm300/601.htm#1064683>.

Table 1: Comparison of Typical Alaska Bypass and Parcel Post Operations

	Alaska Bypass	Parcel Post
Step One:	Acceptance	Acceptance
	Shrink-wrapped pallets of goods are prepared in a warehouse.	Packages weighing up to 70 pounds are accepted like any mail item.
Step Two:	Warehouse Staging	Mail Processing
	Pallets that far exceed Postal Service maximum weight limits are staged for transport to the Anchorage or Fairbanks airport.	Single packages are sorted at a mail processing facility, typically on automated equipment.
		
Step Three:	Air Transportation	Ground Transportation
	Pallets are loaded onto regional airlines and bush planes.	Items are typically moved by truck.
		
Step Four:	Direct Delivery	Mail Delivery
	Alaska Bypass items are directly delivered to the recipient. A typical example is shipments of merchandise being directly delivered to remote merchants.	In the continental U.S., Parcel Post items are delivered as mail. In Alaska, however, outside of major cities with roads, Parcel Post items are delivered to Post Offices for pick-up by the recipient.

Steady Losses

The Postal Service has lost money on the Bypass program since its inception. In fiscal year (FY) 2010, the Postal Service lost about \$73 million on Alaska Bypass.²¹ While the gap between revenue and costs has declined in recent years due to general revenue increases on heavier parcels, we estimate that Alaska Bypass still only covers about 29 percent of its costs. In other words, for every dollar the Postal Service spends on Alaska Bypass, it loses 71 cents. This loss has to be covered by someone. If other Postal Service revenues do not cover this cost as has been the case in the past, then ultimately the U.S. taxpayers might have to.

Table 2: Adjusted FY 2010 Financials

Alaska Bypass	Amount
Revenue	\$30 million
Costs	\$103 million*
Loss	(\$73 million)

* Costs include excise taxes.

Source: OIG analysis of U.S. Postal Service data.

Antiquated Cost Regulation

With no highway system throughout much of Alaska and service concerns with other means of travel, nearly all of Bypass travels by airplane. The costs for this service are inflated by the antiquated system for setting the rates the Postal Service must pay the Alaskan airlines. DOT determines the rates based on the airlines' reported operating expenses. This system provides little incentive for the airlines to reduce their costs and gives the Postal Service limited flexibility to react to changing conditions, such as an increase in fuel prices.²² Currently, the Postal Service pays airlines about \$103 million each year for Alaska Bypass service.²³ It is believed these rates are higher than the market rates the Postal Service would pay if it could negotiate prices directly with the airlines. The DOT process is a legacy of past airline regulation that was designed to support the Alaska aviation industry by subsidizing passenger service and guaranteeing airlines successful operations. Until recently, contract rates for flying international mail were also regulated by the DOT, but these rates were finally deregulated in 2008.²⁴

²¹ This amount includes only the difference between what the Postal Service pays the airlines and what it receives in revenue. It excludes administrative costs associated with the program and allocates some costs in simple ways that may understate Bypass costs. The revenue is from the Revenue, Pieces, and Weight (RPW) system. The cost is from the Postal Service's accounting system combined with the Surface Air Management System (SAMS) Alaska database. Note that without the reduction for Bulk Palletized Rate Application (BPRA), revenue would be about \$36 million. BPRA divides total weight into 70-pound increments and charges the 70-pound parcel post rate for each.

²² For example, in 2008 fuel prices increased sharply and the DOT process simply passed that increase to the Postal Service.

²³ U.S. Postal Service Office of Inspector General (OIG) analysis of Postal Service accounting and RPW data.

²⁴ The Postal Service now contracts directly with the airlines for international airlift, and rates are reported to be lower.

Deregulation of rates provides at least one example of how the Alaska Bypass program could be improved.

Table 3: Adjusted FY 2010 Financials, Costs per Pound²⁵

Alaska Bypass	Amount
Line-haul cost per pound	\$0.65
Ground handling cost per pound	\$0.48
Total Weight	87 million pounds

Source: OIG analysis of U.S. Postal Service accounting and weight data.

Negotiated rates could, for example, lead to lower ground handling costs. The average ground handling rate of 48 cents per pound noted in Table 3 above seems high, since our field research team was told by one mainline carrier in October 2010 that normal ground handlings only cost about 5 to 7 cents per pound for each of the several potential handlings. However, at least two factors contribute to this incongruity. First, required delivery to the recipient's door in Alaska, a service well beyond that accorded mail in rural Alaska, can be very expensive and may require special equipment. Second, the Postal Service does not have the authority to approve or deny "optional" air carrier enhancements, such as freeze and chill rooms to store perishables, and it must eventually pay for a share of such enhancements. That is because the DOT process allocates all ground handling costs, including warehousing.

Low Shipping Prices

To ship Alaska Bypass freight, customers pay rates based on those for Parcel Post, but the actual service given to Alaska Bypass differs substantially from Parcel Post. In the continental United States, Parcel Post is a fully ground service with a delivery standard of 2 to 8 days. It is the lowest priced general parcel product available. In Alaska, Parcel Post has a delivery expectation of 7 to 14 days while Bypass has a service standard of 2 to 7 days.²⁶ Our discussions and other information collected in Alaska suggest that Bypass service is usually very close to 2 days depending on weather and other factors. This level of service makes it similar to Priority Mail (in the continental United States), which is one of the Postal Service's expedited air parcel services. Priority Mail's prices are higher in recognition of its better service including air transportation if necessary. It would, therefore, seem reasonable for the Postal Service to at the very least charge Priority Mail rates for Bypass since it generally exceeds Priority Mail service in Alaska.

²⁵ Any difference between the total cost in Table 2 and the computed cost in Table 3 can be accounted for by the excise tax which is not included in the figures in Table 3.

²⁶ In Alaska, both Postal Service Priority Mail and Commercial General Air Freight have a delivery standard of 3 to 5 days while Commercial-expedited Air Freight has a standard of 1 to 4 days.

Prior to 1997, Alaska Bypass costs were included in the pool with all Parcel Post in the Postal Service's cost systems. When it became known that the Alaska Bypass losses were starting to have a major adverse (upward) effect on Parcel Post's cost-based rates, domestic parcel mailers reasonably pushed the then-Postal Rate Commission (PRC) to make changes, as they alone were paying the costs of the Alaska Bypass subsidy. The PRC eventually approved a new method to spread the impact to all classes of mail by creating the Alaska Air Adjustment.²⁷ This method imagines a road network throughout Alaska and allocates all extra costs in Alaska above this to the Postal Service's institutional costs to be borne by all mailers.

In 2009, a rate increase on Market Dominant classes of mail (PRC Docket No. R2009-2) precipitated a backlash from Alaskan politicians and interest groups who were worried about how the increase in Parcel Post rates would affect Bypass rates. In response to such pressure, Alaska Bypass avoided the full increase in rates that other heavy weight parcel shippers experienced because the Postal Service instituted a new method allowing Bypass rates to be calculated by dividing the large, several hundred-pound pallets into 70-pound increments for pricing purposes. This new method, called Bypass Palletized Rate Application (BPRA), resulted in a lower price increase for Bypass than for similar weight Parcel Post, even though Bypass rates were already well below costs. We estimated that this change lowered what Bypass revenues would have been by approximately \$6 million.

Economic Impact

In the face of significant and steady losses, attempts to modify the Bypass program have continued to be met with determined resistance from Alaska stakeholders. While protecting one's interests is a standard reaction to any change, some stakeholders may be basing their resistance to Bypass Program reform on outdated assumptions. While the interests of rural residents were at the forefront in the early years of the program, these residents no longer appear to derive a proportional benefit.

Rural Residents Still Pay High Prices

It is often stated that shipping goods via the Bypass program is intended to keep costs affordable for Alaskans living in remote villages. However, Alaska bush residents continue to pay a premium for many goods, including common groceries. For example, a 14-ounce bag of Ruffles™ potato chips in Anchorage costs \$4.29 retail.²⁸ The two grocery stores in Bethel, a village of about 3,500 and a Bypass hub location, both

²⁷ The Postal Service periodically conducts a study to estimate what the cost of Alaska non-priority transportation would be if it were transported by surface rather than by air. The last update filed in Postal Regulatory Commission Docket No. R2005-1 used FY 2004 data, and concluded that the "surface" costs were approximately 7 percent of the actual air costs. This adjustment is applied to both line-haul and terminal handling costs. This reduces the parcel post cost from \$116 million to approximately \$8 million, with a corresponding per-piece reduction from \$47.46 to \$3.32. The other 93 percent becomes a Postal Service institutional cost not attached to any product or mail class. U.S. Postal Service Library Reference No. USPS-LR-K-36, "Calculation of Alaska Air Adjustment," <http://www.prc.gov/prc-pages/library/detail.aspx?docketId=R2005-1&docketPart=Documents&docId=43278>.

²⁸ OIG field research, October 2010.

charge customers the exact same price — \$9.99 per bag.²⁹ It could cost as little as about 35 cents to send that bag via Alaska Bypass (as part of a 1,000-pound minimum shipment). In addition, it is likely the Bethel grocer would pay wholesale for the Ruffles, not the Anchorage retail price. The stores, therefore, mark up the price of Ruffles by far more than 100 percent. In fact, the stores could possibly still offer the identical price of \$9.99 per bag profitably even if it were delivered via the private freight market, whose rates could be five times higher (35 cents x 5 = \$1.75).³⁰

Other examples abound. Anchorage residents pay \$3.49 for Colgate™ toothpaste (5.8 ounces), which might cost as little as 14 cents to ship, but Bethel residents pay \$4.59 at the local stores. Similarly, Bethel merchants mark up a large tin of coffee by 100 percent over costs. While there are limited exceptions to this phenomenon — milk in Bethel costs less than retail milk in Anchorage — the overall trend of extraordinarily high prices at rural merchants is supported by statistics from the Alaska Department of Labor and Workforce Development, which reports prices for a market basket of groceries.³¹ In small remote villages serviced by Alaska Bypass, the grocery prices seem to bear little relationship to the cost of getting the products there and may include a variety of other factors.³²

Passenger Service Supply Greatly Exceeds Demand

Rural residents derive one significant benefit from Alaska Bypass in that passenger air service is frequent and relatively inexpensive. Alaska Bypass has contributed to the extensive availability of passenger air service from Anchorage and Fairbanks to hub and bush destinations. For example, there are 90 flights per month between Anchorage and King Salmon, a town with 374 residents, but only 80 flights per month between Anchorage and Juneau, the state capital, a city with 31,275 residents.³³ In addition to the level of service, it is interesting to note the surplus of passenger seats to Bypass destinations. While the United States national average passenger seating capacity utilization is over 80 percent,³⁴ only 40 to 50 percent of passenger seats are filled to Bypass destinations.

Rural Merchants Reap Benefits

Rural merchants seem to be among the biggest beneficiaries of the Alaska Bypass program. Whether a grocery store or pizzeria, they have their supplies delivered quickly to their door for a very low price. In fact, Alaska Bypass shippers pay prices based on Parcel Post rates, not freight rates or even Priority Mail rates, although they receive

²⁹ Ibid.

³⁰ A 1990 federal government study of the mail system in Alaska estimated that the cost of sending 1,000 pounds of Bypass from Bethel to Anchorage by air freight would cost five times that of sending it via Parcel Post (\$336.00 compared to \$71.60).

³¹ See Appendix D for a summary of the market basket of goods.

³² OIG research and Alaska market basket data.

³³ Juneau population includes the city of Juneau (urban population: 17,311) as well as the Greater Juneau Borough.

³⁴ U.S. Bureau of Transportation Statistics, <http://www.bts.gov/>. This information can also be developed from <http://nsflight.com/data/ANC.html>.

expedited treatment that often exceeds that of Priority Mail or commercial freight in Alaska.³⁵ The goods are actually handled like freight, a much more costly service and one that the Postal Service does not provide customers in any other part of the country.

Since these local stores have little or no competition, they have little incentive to pass along the significant transportation savings they enjoy. To the extent that rural merchants realize such cost savings on Alaska Bypass deliveries, it is possible that those savings are not fully passed along to local customers. Bypass shippers, which prepare and coordinate shipments between the Postal Service and the airlines, provide a valuable service and generally operate in a more competitive environment. However, some urban shippers also maintain retail operations in rural communities, allowing them additional benefits related to the Bypass program. It is interesting to note that one Canadian company both ships about 25 percent of the volume out of Anchorage and Fairbanks and also owns over 30 of the local (monopoly or near monopoly) stores.

Alaskan Air Carriers Benefit from a Non-competitive, Regulated Market

Alaskan air carriers, both mainline and bush, reap significant benefits from the Alaska Bypass program, and more generally, the program also provides support to the aviation industry. Further, maintenance of the aviation industry indirectly supports the tourism industry in Alaska, another significant source of revenue for the state. The equitable tender regulations tie Bypass directly to passenger service in Alaska by making the provision of a minimum number of passenger flights a prerequisite for receiving equitable tender of Bypass shipments. As indicated previously, the Congressional findings from the introduction to RSIA cite the provision of passenger service as a goal of the Alaska Bypass, even though there is already a federal program designed to do just that already operating in Alaska, namely the Essential Air Service program. Finally, the cost-regulated DOT rate system ensures that airlines' costs are covered and there is little incentive to reduce those costs since the Postal Service must pay them. If the Postal Service were allowed to contract for air service at market rates, it is possible that the service could be significantly cheaper.

³⁵ Priority Mail is the Postal Service's 2-to-3-day expedited service. In the contiguous states, Parcel Post is a deferred package service, whereby packages move via ground transportation.

Bypass Discourages the State of Alaska from Providing Appropriate Infrastructure

Because the Postal Service bears almost all the cost of delivering goods to rural merchants, the Alaska state government does not bear the costs associated with providing necessary air or ground infrastructure and has little incentive to increase its responsibility. Yet the Alaska Permanent Fund had almost \$40 billion by October 2011 and is projected to grow to more than \$80 billion by the end of FY 2022.³⁶ Alaska residents have no state income tax or sales tax. They have the lowest gasoline taxes in the United States and receive an annual dividend from the state, which in 2010 was \$1,281 per resident. The Alaska Bypass loss was about \$100 per resident. The state appears to be in the position to assume greater responsibility for the Bypass program losses or, alternatively, to contribute toward the development of road and air infrastructure to provide a suitable alternative to the current system.³⁷ The state of Alaska is currently pursuing a number highway expansion programs but these expansions are often slow to start. For instance, there is a proposed highway from Fairbanks to Nome. Alaska estimated that fuel, freight, and mail transport costs for the six case study communities would decrease by about \$19.1 million per year if road transportation were used instead of air.³⁸

Further, Alaska is accorded special treatment not provided to rural residents in other states. Packages destined to rural customers in Montana, Idaho, and Wyoming, for example, are processed and delivered as regular mail. The Postal Service's restrictions on weight and allowable material in the mail apply. Bulk shipment of goods and commodities is not allowed via the Postal Service and must move as private freight in all other states.

Table 4 on the next page summarizes the impacts on various Alaska Bypass program stakeholders.

³⁶ The assets of the Alaska Permanent Fund are managed by a semi-independent, state-owned corporation, established by Alaska in 1976. Funded in large part by oil revenues, the Alaska Permanent Fund is now widely diversified across a number of financial areas. Its current balance is about \$40 billion and it pays an annual dividend to every resident. It owns such major commercial real estate in the continental United States as the upscale Tysons Corner Center outside Washington, D.C.

³⁷ In at least once instance, a road was constructed to a Bypass destination, but the Bypass program continued, albeit via tractor-trailer, and there have been complaints about the service degradation.

³⁸ Dowl HKM, "Western Alaska Access Planning Study: Corridor Planning Report," prepared for the Alaska Department of Transportation and Public Facilities, <http://www.dowlhkm.com/projects/westernalaskaaccess/January%202010%20Corridor%20Planning%20Report.pdf>.

Table 4: Alaska Bypass Program Stakeholders

Stakeholders	Benefits	Cost Impacts
U.S. Postal Service	Avoids processing	Loses money
Anchorage and Fairbanks Cargo Fulfillment Shippers	New industry	None
Mainline Air Carriers	Profitable, protected by statute	None
Bush Carriers	Presumably profitable, protected by statute to a degree	None
State of Alaska	Gains infrastructure subsidy and landing fees	None
Retail Merchants	Low product delivery costs	None
Rural AK Residents	Passenger service subsidy, but minimal commodity cost savings	None
U.S. Government	Minimizes rural air subsidies	None
Postal Ratepayers in Continental U.S.	Almost none	Fund 70 percent of the program

Source: OIG analysis.

Conclusion and Policy Options

The Alaska Bypass program’s original purpose to provide affordable and reliable service to rural Alaskans and help the Postal Service operate more efficiently has morphed into a program that puts the Postal Service in the position of financially supporting the aviation industry, the State of Alaska, bush merchants, and others. The Postal Service cannot afford to subsidize a service that has expanded beyond its original purpose and does not appear essential to the Postal Service’s mission to bind the nation together through the provision of reliable, affordable, universal mail service.

The Office of Inspector General suggests a reform of Alaska Bypass to better meet its original goals in a more cost effective and appropriate way. Such changes may include the following:

- The Postal Service could be allowed to negotiate rates directly with the airlines as it does outside of Alaska. The DOT cost-based rates provide little incentive for Bypass airlines to lower their costs and result in unnecessarily high costs for the Postal Service.
- The Postal Service could be allowed to more freely implement appropriate cost-savings measures. The Bypass program’s structure restricts the Postal Service from more efficient operations and introducing cost-saving initiatives. In addition, the mandatory 12-month public hearing process hinders operational changes.

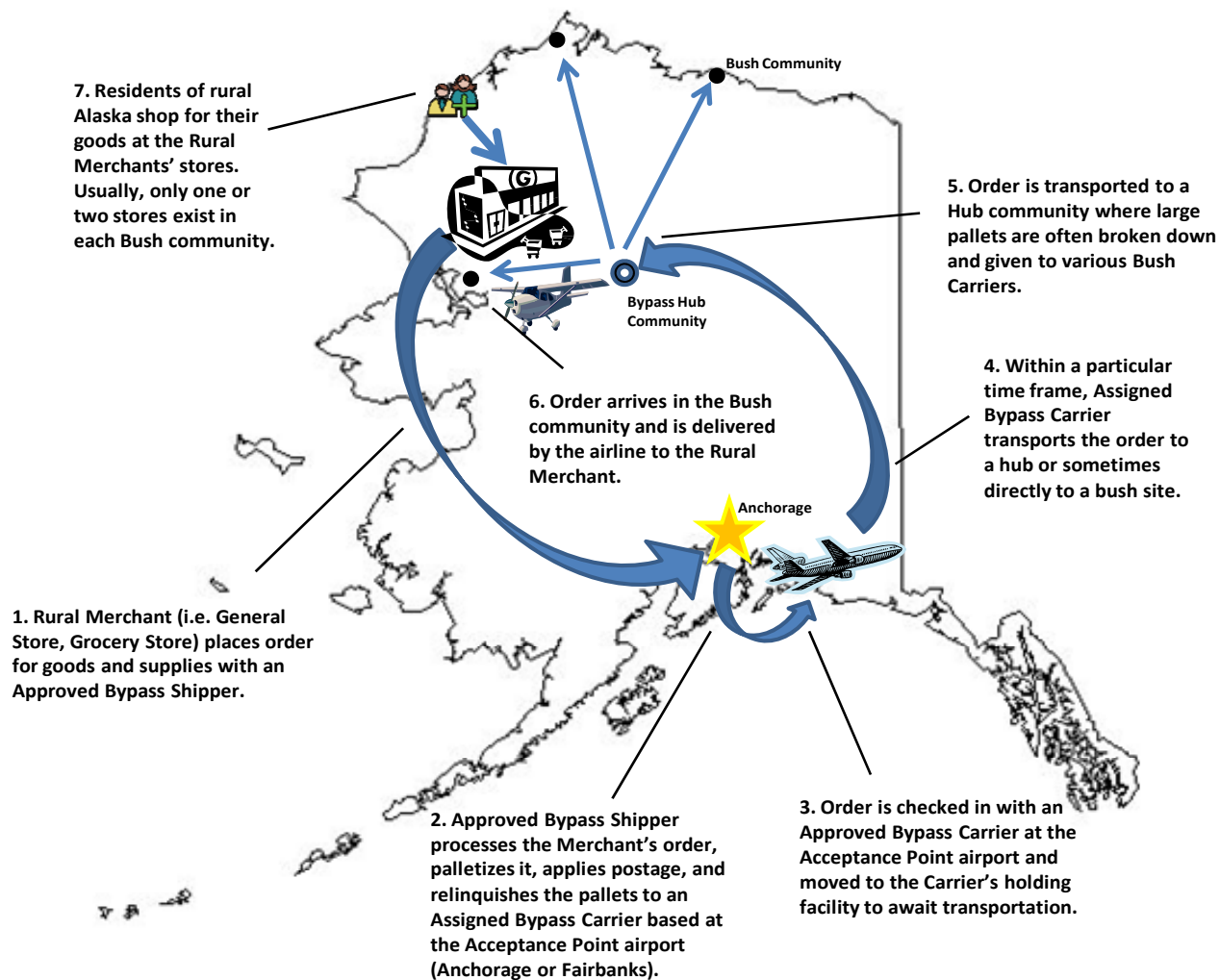
- The law could be changed to eliminate the statutory restrictions on new entrants to the mainline and bush air carrier markets. The restrictions create a protected market for existing carriers and may drive up costs to the Postal Service.
- The Postal Service could at the least charge Priority Mail rates instead of lower Parcel Post rates. Today, recipients pay preferential ground Parcel Post rates for better than Priority Mail air service. Charging Priority Mail rates would be somewhat more consistent with the service received, but only slightly lessen the considerable losses of the current Alaska Bypass program.
- Alaska Bypass could be made its own breakeven program regulated by the Postal Regulatory Commission. Allowing the Postal Service to charge cost-based prices to recipients identical to the rates it pays air carriers would eliminate the Postal Service's considerable losses and start to introduce appropriate incentives.
- The federal government or the State of Alaska could reimburse the Postal Service for the losses associated with this program. In addition, Alaska could use its funds to invest in infrastructure to better serve its residents.
- The Postal Service could be completely removed from the Alaska Bypass program since it plays only a minimal role in the process today outside of paying for it. Shipment of commodity goods to remote merchants could be ceded to the private sector freight market in Alaska — as it has in the other 49 states.

Without at least some of these changes or others, the Postal Service will continue to suffer significant losses on the Alaska Bypass program at a time when it can least afford it.

Appendices

Appendix A Alaska Bypass Process

Figure 2: Functioning of Alaska Bypass Process



Source: OIG field research.

Appendix B Alaska Bypass Timeline

Table 5: Timeline of Key Events

Year	Event
1924-25	Airmail Service in Alaska begins. Kelly Act initiates comprehensive airmail service throughout the United States.
1930	Airmail Act of 1930 creates first mail-based subsidy for commercial airlines. Pays for planes' capacity rather than for actual weight carried.
1938	Civil Aviation Act creates Mail Pay, first formalized commercial aviation subsidy targeted at service in rural communities. CAA set pay rates.
1968	Four airlines given exclusive certifications for delivery of mail within the state of Alaska.
1972	Bypass System begins.
1978	Airline Deregulation Act deregulates airlines throughout the United States. Essential Air Service institutes a subsidy to protect rural passenger air service.
1984	Provision added to Title 39 preventing Postal Service from directly contracting for air service within the state of Alaska.
1988	Regulations added to Bypass including a minimum number of flights for airlines and public notice requirements for the Postal Service.
2002	RSIA (Rural Service Improvement Act) creates equitable tender for carrying Bypass and gives preference to passenger carriers.
2009	BPRA (Bypass Palletized Rate Application) introduced to lessen the impact of the heavyweight Parcel Post price increase.

Appendix C Example of an Alaska Bypass Pallet

Figure 3: Picture of an Alaska Bypass Pallet



Source: OIG field research.

Appendix D Market Basket Statistics

The Alaska Department of Labor and Workforce Development produces a monthly publication entitled *Alaska Economic Trends*. The August 2010 issue focuses on cost of living and provides a wealth of information about prices throughout Alaska. It includes prices for a market basket of groceries for a week for a family of four in many cities and towns throughout the state.³⁹

**Table 6: Market Basket of Groceries for Selected Cities
(March 2010)**

City	Cost
Anchorage	\$123.89
Bethel	\$251.75
King Salmon	\$304.87

Source: University of Alaska Fairbanks August 2010 survey.

The price information is from the University of Alaska Fairbanks, which performs a quarterly survey of individual item grocery prices throughout the state. All together, the market basket weighs approximately 162 pounds, and its contents can be viewed in the table on the next page.⁴⁰ Bypass shipping to both Bethel and King Salmon from Anchorage would cost \$62. So the price in the two communities, with the Anchorage retail profit margin already built in, would be approximately \$124 plus \$62, or \$186. Yet, the price to the consumer is 30 percent higher in Bethel and 60 percent higher in King Salmon.

These communities are both in southwest Alaska and are both Bypass hubs.⁴¹ One difference, however, is the number of grocery stores. Bethel has two, Alaska Commercial Company and Swanson. King Salmon has only one, the Alaska Commercial Company, although the Naknek Trading Company is located about 15 miles down the road in Naknek. Automobile ownership does not seem to be universal. For example, we observed many pedestrians in Bethel who appeared to be walking long distances. There is no public transportation, although taxis are plentiful, but very expensive.

³⁹ Neal Fried, "The Cost of Living in Alaska," *Alaska Economic Trends*, 30 No. 8 (August 2010) <http://labor.alaska.gov/trends/aug10.pdf>, p. 8.

⁴⁰ A detailed list of the market basket's contents per month is available on the University of Alaska Fairbanks Cooperative Extension Service's website at <http://www.uaf.edu/files/ces/fcs/foodlist.xls>.

⁴¹ The DOT rate paid by the Postal Service to transport this weight to Bethel, about \$112, is somewhat higher than the rate to transport it to King Salmon, about \$96, because of a slight difference in distance.

Table 7: Grocery Market Basket Contents and Weights

Product Class	Number of Products	Total Gross Weight	Examples
Fresh Fruit and Vegetables	13	19 pounds	White Potatoes, Onions, Oranges
Canned Goods	21	38 pounds	Green Beans, Peaches, Canned Apple Juice, Canned Chili w/Beans
Dry Goods	29	27 pounds	Rice, Potato Chips, All Purpose Flour, Sugar (granulate), Coffee
Meat, Eggs, and Dairy	26	53 pounds	Eggs (dozen), Ground Beef, Bacon, Butter, Milk
Frozen Goods	7	9 pounds	Frozen Pie Crust, Frozen Orange Juice Concentrate
Other	7	14 pounds	Coke (2 Liter), Peanut Butter, Mayonnaise
Total	103	162 pounds	

Source: OIG analysis of University of Alaska Fairbanks data.