
Collected Papers on Specific Postal Policy Issues

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1

Estimating the Effect of Cross Border Liberalisation on Universal Postal Service (1993)*

In June 1992, the European Commission published the first official study of the delivery services sector in Europe. After lengthy legal and economic analysis, the “Postal Green Paper” proposes a set of guidelines and principles for European Community policy towards public and private delivery services. The moving spirit for Postal Green Paper is the vision of a Single European Market in which goods and services can move freely among the national economies of the Community.

The single most significant recommendation of the Postal Green Paper is liberalisation of the cross border market. If accepted, both public and private delivery services would be permitted to pick up letters, documents, and small parcels in any Member State for delivery to an address in any other Member State or export from the Community altogether. Public and private delivery services would be allowed—indeed, they would be competitively compelled - to develop Community level “postal” systems that would supplement national postal systems without being limited by them.

The central role of a high quality, Community level delivery system in a Single European Market is obvious for the large companies and large direct marketing firms that are trying to build European markets. They strongly support this proposal of the Postal Green Paper. It is perhaps less obvious that the ultimate beneficiaries of a good system of communications and delivery—whether one looks at the national or regional scale—will be smaller firms and those who live outside the major cities. With a better Community delivery system, it will be easier for Harrods to expand its business to Germany or Italy. Without a good Community delivery system, it will be impossible for a specialty retailer in small town in Ireland

*Paper presented at a seminar held by Wissenschaftliches Institute für Kommunikationsdienste, "The Economics of Universal Service," Königswinter, Germany 20-21 April 1993.

to do so.

Despite the manifest benefits of cross border liberalisation for the Community level economy, most European postal administrations oppose this recommendation. The postal administrations do not so much question the Community level benefits as they raise the prospect of unacceptable damage to the universal service network at the national level. So serious is this threat, argue some postal officials, that the best Community level policy is to maintain, indeed to reinforce, the current system of apportioning the collection and delivery of cross border traffic among twelve national postal monopolists. Such a solution protects the economic strength of national postal administrations and thus preserves the base of essential delivery services at national level. If universal service at the national level is undone, good quality Community level delivery services would be meaningless.

No one doubts the economic and social importance of the national postal systems. The possibility of substantial injury to these services must therefore be taken seriously. The purpose of this paper is to offer some suggestions about how one might systematically and quantitatively evaluate the claim that liberalisation of cross border traffic will undermine the ability of postal administrations to provide affordable universal service at national level.

My analysis is approximate and illustrative only. It is not meant to substitute for a more refined economic analysis using actual postal data. My hope, indeed, is to encourage such analysis. The fundamental point of this paper is to emphasize that further progress in the policy debate begun by the Postal Green Paper requires a quantitative approach by all parties.

1. POSTAL ARGUMENTS AGAINST CROSS BORDER LIBERALISATION

The gist of the postal administrations' concern about liberalisation of the cross border market appears to be the fear that if the cross border market is liberalised, private cross border operators will "cream skim" the "most profitable" portion of the domestic postal traffic. How will this occur? A large domestic mailer in Member State A could give his mail to a cross border operator to carry his mail out of country A and then back into A for delivery, thus converting what is normally domestic traffic into cross border traffic and escaping the domestic postal monopoly. Alternatively, and more efficiently, the large domestic mailer could use modern electronics to print his mail in another EC Member State and tender the mail to the cross border operator there, for delivery to addresses in Member State A.

Of course, compared to a domestic postal service, a cross border delivery service incurs the additional cost and delay inherent in cross border transportation. How, then, can the cross border operator compete with a reasonably efficient postal administration for domestic mail service? The answer, say postal administrations, is that mail is less expensive to deliver in some areas than in other areas. Centre city postal service, for example, is the least expensive. Service between cities and to outlying areas is more expensive, and service to rural areas is the most expensive of all. Postal administrations, however, do not charge rates that reflect these cost variations. Rather, the government has imposed upon postal administrations a

“public interest” requirement that they maintain a uniform postage rate for the entire nation. This uniform postage rate creates a geographic cross subsidy between city postal services and rural postal services.¹

If the cross border market is liberalised, cross border operators (private operators or other postal administrations) will confine their operations to the areas in which delivery costs are lowest, thus depriving the postal administration of a large fraction of the “profit” needed to cross subsidise the “losses” incurred in rural service. If this cream skinning is allowed to occur, rural service—and hence, universal postal service—will be gravely threatened.

This, as I understand it, is the basic line of reasoning proffered by postal officials who oppose liberalisation of the cross border market.

This argument is almost always presented without reference to quantitative economic data. In the following, admittedly simplistic, discussion, I will try to attach plausible numbers to this argument. I believe that this exercise will show the importance of quantitative analysis. Indeed, the persuasiveness of the postal officials’ case depends entirely upon the numbers. Unless numbers are attached, it is impossible to evaluate the argument and, under the free trade principles of the EC Treaty, monopoly restrictions upon intra Community trade must be terminated unless they are demonstrably necessary to further the public good. Numbers are not only necessary to sustain the merits of the postal officials’ argument against cross border liberalisation, they are also helpful to a consideration of alternatives and transition mechanisms. So, to those postal officials who oppose liberalisation of cross border traffic, I would say, “Bring out your numbers!”

2. STRUCTURE OF THE GEOGRAPHIC CROSS SUBSIDY

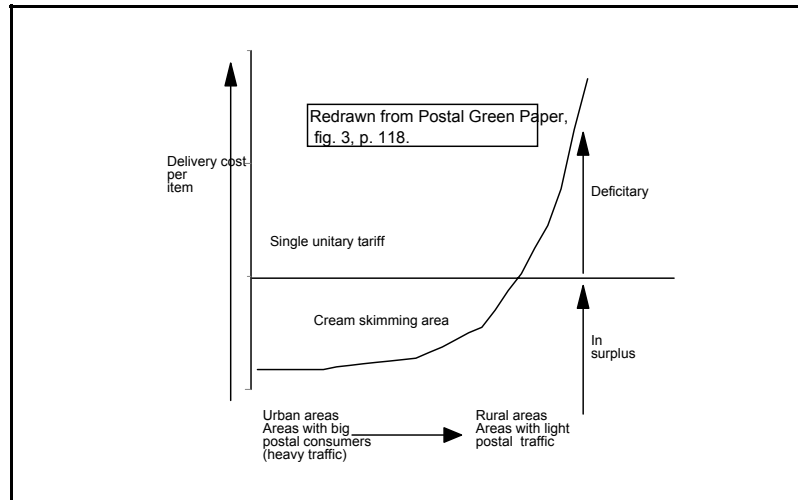
Even in the absence of solid postal data, however, some insights can be achieved by reasoning from incomplete data, using hypothetical numbers where necessary. At the heart of postal opposition to cross border liberalisation lies a presumption about the structure of the geographic cross subsidy. The Postal Green Paper illustrated the structure of the cross subsidy with the line graph shown in Figure 1.² The Postal Green Paper gave no data or details to support this graph, however. It is obvious, however, that the graph is not drawn to scale, for the area of the “cream” is much larger than the area of “deficiency”. Plainly, if the purpose of the “cream” is to pay for the deficiency, they must equal each other.

In quantitatively analyzing the potential impact of cross border liberalisation on universal service, the first step is to define this graph more carefully. We

¹Of course, a cross border operator could also take advantage of postage rates that vary substantially from costs in other respects. However, postal administrations are increasingly adjusting their rates for subsets of mail which have significantly different cost structures. In fact, the Postal Green Paper encourages cost based postage rates with the sole exception of those rates that support a geographic cross subsidy. It is, moreover, the geographic cross subsidy that most postal officials cite to explain the dangers of cross border liberalisation.

²Chapter 5, section 6.1, figure 3.

Figure 1. PGP graph on profitable and loss making areas



can begin by imagining that postage for a typical document covers three basic cost

components. First, there is the cost of collection and sorting in the originating post office. Second, there is the cost of transport from the originating post office to the destination post office. Third, there is the cost of sorting at the destination post office and actual delivery by the postman.

Figure 2 illustrates this simple cost model for a typical letter. In my figure, the postage rate is arbitrarily set at 100 money units. The percentages for cost components are roughly those suggested by postal officials. I have used 22 percent for collection and outward sorting, 6 percent for transport, and 72 percent for inward sorting and delivery.³

It is important to note that some of these costs are variable and some are fixed. According to postal economists most of the fixed costs are involved in establishing the basic delivery system. If a postal administration had no letters to collect or transport it would incur little cost. A universal delivery capability, however, requires a basic minimum structure of offices and equipment regardless of the mail to be delivered. Once these fixed costs are paid, an increase in the amount of mail to be delivered does not generate a proportional increase in the costs of delivery. Put another way, it is the delivery function where a postal administration experiences substantial economies of scale. Simplistically, I have divided the delivery function into fixed and variable costs, using a 50-50 split. The fixed costs are shown in solid colours in Figure 2. Overall, my approach yields a fixed cost factor of 36 percent for

³See Roger Tabor, "Comment" in Crew, M. & Kleindorfer, P., eds. *Competition and Innovation in Postal Service* (Norwell, Massachusetts: Kluwer Academic Publishers, 1991). Mr. Tabor, then head of corporate planning for the U.K. Post Office, used 25 percent for collection and 75 percent for delivery, without allowing anything for transportation. According to figures of the U.S. Postal Service, transport between post offices accounts for about 6 or 7 percent of total costs. The Postal Green Paper reports similar, but slightly different figures: 28 percent for collection and outward sorting; 2 percent for transport; and 70 percent for inward sorting and delivery. Chapter 5, section 3.

Figure 2. Basic cost components of postal service

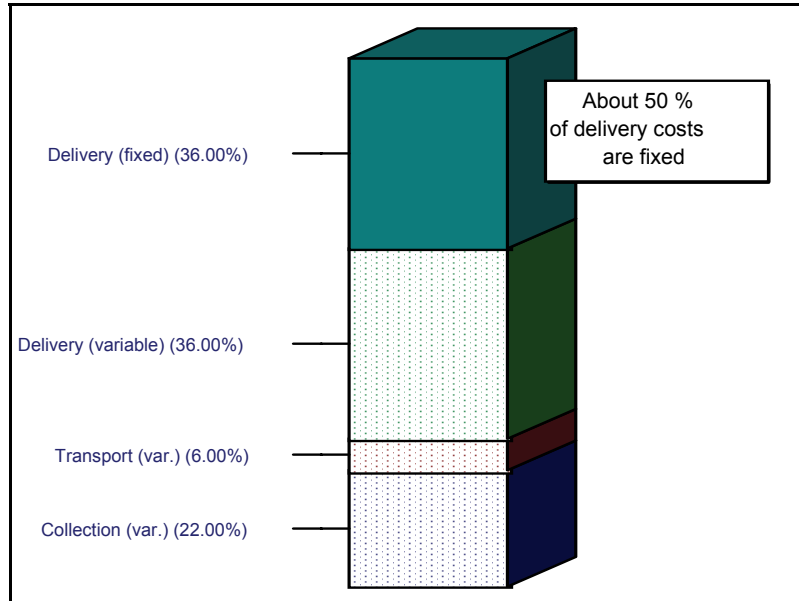
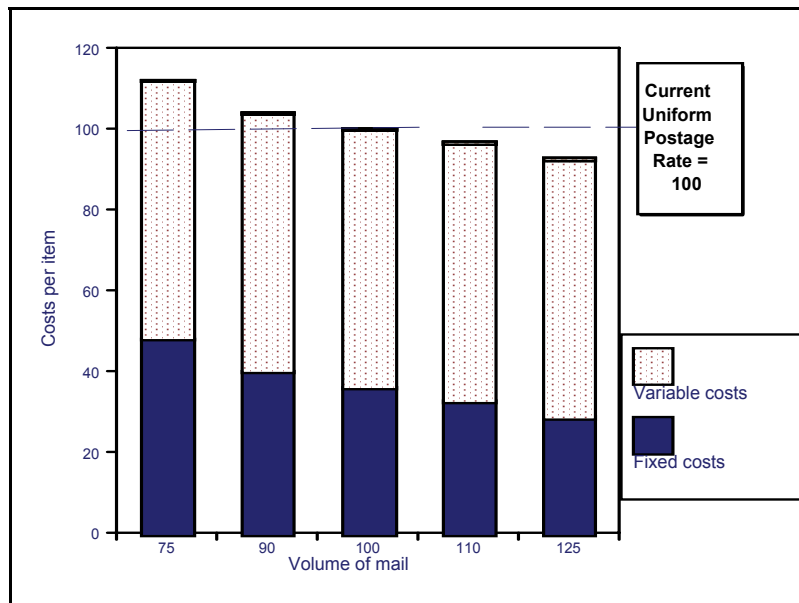


Figure 3. Effect of mail volume variation on uniform postage rate



postal costs as a whole.

The importance of fixed costs is illustrated in Figure 3. For a given level of fixed costs, the greater the mail volume, the lower the fixed cost component for the typical letter. This effect, however, is not as drastic as many suppose. Using my illustrative figures, a decline of 25 percent in mail volume would cause an increase in the uniform postage rate of only about 12 percent. A decline of 10 percent would imply a rise of 4 percent.

Figure 4. Effect of variable cost variation on mail profitability

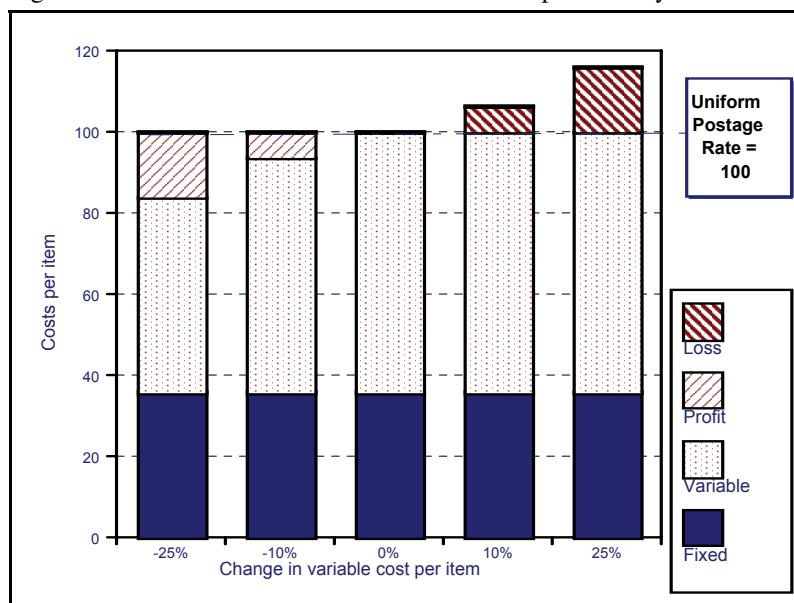


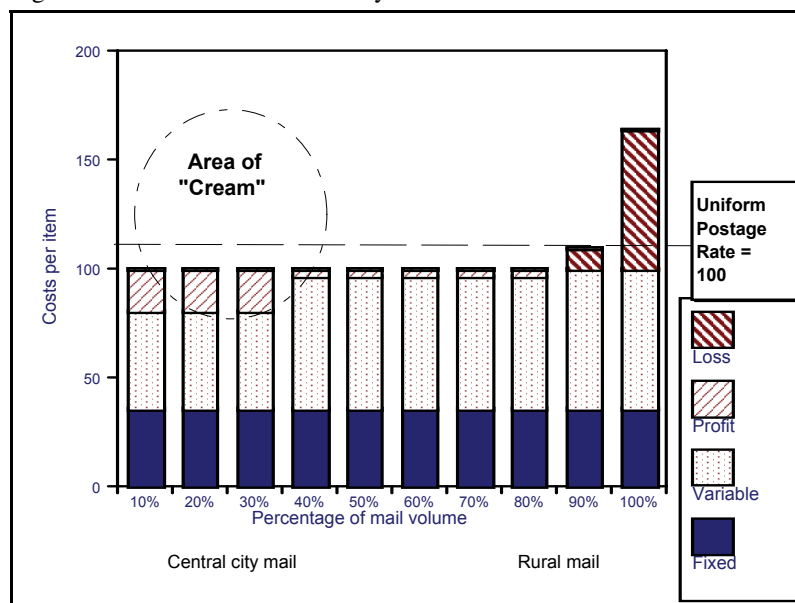
Figure 3 assumes that the variable costs for all mail are the same.⁴ As noted above, however, postal officials suggest that it is significantly less expensive to provide postal services in some areas than other areas. The low cost areas are the “most profitable” postal areas which, it is argued, will be cream skimmed by private cross border operators.

Figure 4 illustrates the effect of varying variable costs. Where variable postal costs—including collection, transport, the variable portion of delivery costs—are 10 percent less than the average, the total cost of postal service is 94 money units instead of the system wide average of 100. Since the uniform postage rate is set to cover average costs overall, the postal administration makes a “profit” of 6 money units in such low cost postal areas. This profit is, according to the argument of postal officials, used to cover losses incurred in rural service. Conversely, where variable costs are 10 percent greater than the average, the cost of postal service is 106 and the postal administration loses 6 money units on such service.

In postal service, the structure of the cross subsidy is determined by this variation in the level of variable costs. Using this approach, Figure 4 provides an imaginary structure for the cross subsidy in Post Office “A”. Figure 4 is thus a more quantitative version of the cost curve from the Postal Green Paper reproduced in Figure 1. In Figure 4, I have assumed that postal “profits” are concentrated in areas that represent about 30 percent of the mail, rather than spread evenly across the non rural mail stream. Post Office “A” is thus considerably *more* vulnerable to cream skimming than implied by the cost curve used by the Postal Green Paper.

⁴From any accounting standpoint, fixed costs may be allocated equally to all mail. The accounting convention adopted is not critical to the analysis in the text.

Figure 5. Structure of cross subsidy in Post Office "A"



At the other end of the spectrum, I have assumed that the average variable cost for the last 10 percent of the mail is *twice* as great as for the average letter. More limited losses are assumed for the next to last 10 percent of mail. According to postal data available, these assumptions seem to provide a generous allowance for losses on rural mail. For Post Office "A", the losses incurred in rural service increase the cost of all mail by about 7 money units.

The assumed structure of cross subsidy clearly reveals the nature and amount of "cream" which may be vulnerable to diversion by cross border operators. We must now ask to what extent the proposed liberalisation of cross border service will allow them to do so.

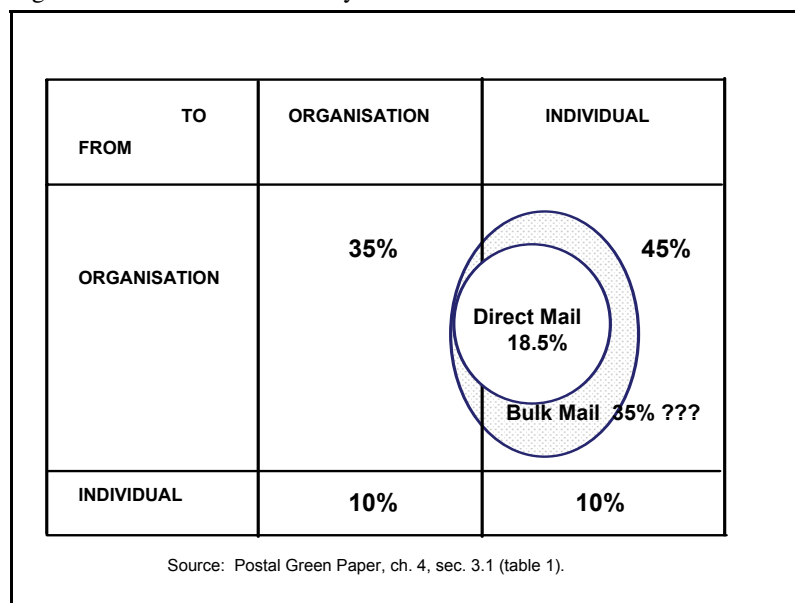
3. MOVEABILITY OF MAIL

The next question that must be considered is what fraction of the mail can realistically be moved from the domestic to the cross border market. Except for the smallest Member States with land borders, it seems to me that most observers would agree that the potential for migration from the domestic to the cross border market lies in the possibility of "remote printing". In order to consider the potential for remote printing let us consider another diagram from the Postal Green Paper.

Figure 5 reproduces a matrix from the Postal Green Paper that summarized the identity of senders and receivers of mail.⁵ It may be seen that about 80 percent of the mail originates from businesses and that most of this goes to individuals. Remote printing is clearly most amenable to large batches of identical or nearly identical items. This would include "direct mail", which the Postal Green Paper estimates to

⁵Chapter 4, section 3.3, table 1.

Figure 6. Distribution of mail by sender and addressee



be 18.5 percent of all mail.⁶ Direct mail is, however, only a subset of a larger category that some have called “bulk mail”. Bulk mail would include invoices and statements of account.

In my calculations, I have guessed that the total volume of bulk mail may be twice as large as direct mail (the Postal Green Paper makes no estimates for bulk mail). Under this assumption, bulk mail would account for 35 percent of all mail, or nearly one half of all business generated mail. That is, as much as one third of all mail might be considered more or less “moveable” from the domestic market to the cross border market.

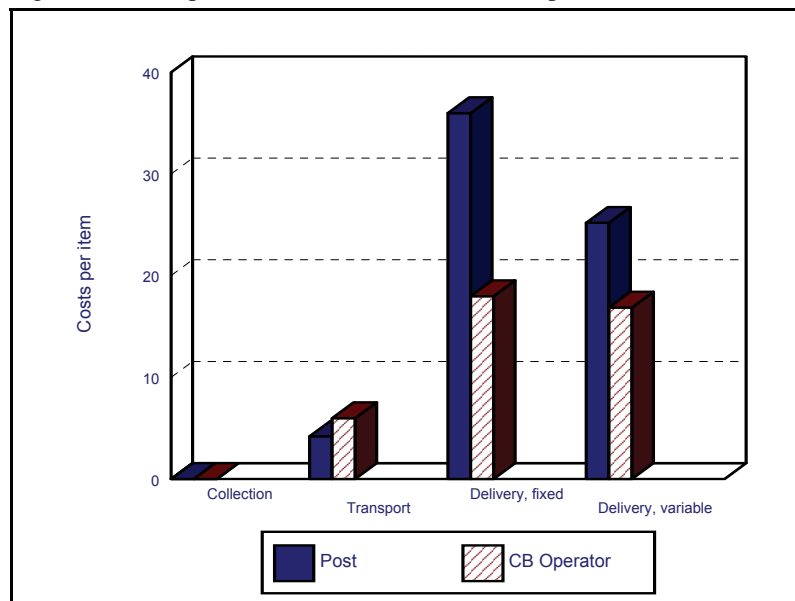
The moveability of mail needs to be considered in light of the structure of the geographic cross subsidy discussed above. It seems reasonable to suppose, for example, that businesses tend to send relatively more bulk mail to individuals than to other businesses. It also seems reasonable to suppose that mail sent to the lowest cost areas is more likely to be business mail than individual mail. Both of these factors suggest that mail to the “most profitable” areas is less likely to be “moveable” than mail to the average or high cost areas.

4. COSTS OF A CROSS BORDER OPERATOR

Once the “cream” and the “moveable” mail have been identified, it is necessary to provide a clear eyed assessment of the economics of potential cross border operators. A cross border operator will, of necessity, have a cost *structure* that is similar to the local postal administration. However, as a new competitor, it may be able to achieve lower cost *levels*.

⁶Chapter 4, section 3.4.2.

Figure 7. Development of costs of a cross border operator



Since the cross border operator is likely to be confined to bulk mail that is amenable to remote printing, I have assumed that the cross border operator has negligible collection costs. I have assumed that his *cross border* transport costs will be equal to the average *domestic* transport costs experienced by the postal administrations, 6 money units. This undoubtedly underestimates transport costs.

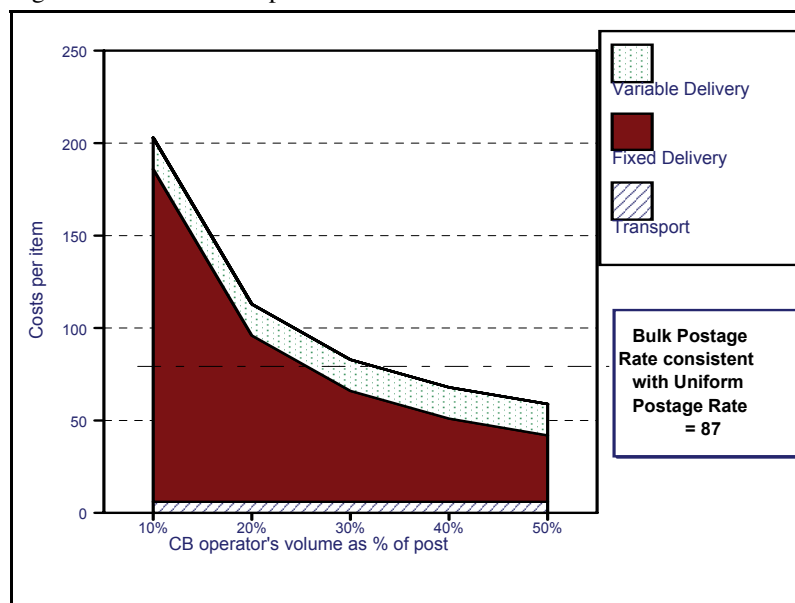
In regard to delivery costs, it should be noted that the postal administration itself has unusually low delivery costs in the “most profitable” areas. In my example, I assumed that postal administration’s variable costs per item in the most profitable areas are 30 percent less than the average variable costs for all mail. This implies that

the *variable* cost component of postal delivery in the “most profitable” area of 70% x 36 or 25 money units. For the postal administration, however, the fixed cost component for delivery remains at 36 money units per volume unit.

I have arbitrarily assumed that the cross border operator can reduce the fixed costs compared to the postal administration by 50 percent for a given (substantial) unit of mail. That is, if a cross border operator delivers as much mail as the postal administration, his fixed cost would be 18 instead of 36 money units per item. Variable costs for the cross border operator (which would be mainly wages) were assumed to be two thirds of the postal standard. Figure 6 shows the assumptions used to develop the costs of the cross border operator.

Just as for postal administrations, the cross border operator’s fixed cost per item will vary according to the amount of mail handled. This, indeed, is likely to be the most important commercial obstacle faced by a cross border operator. How will he obtain sufficient volume to achieve the economies of scale necessary to compete with the postal administration? Figure 7 illustrates the problem.

Figure 8. Cross border operator's costs at different volumes



It should be noted that, since the cross border operator is handling bulk mail, he must compete with the postal administration's bulk mail rate. If we assume that the postal administration, like the cross border operator, does not incur a significant collection cost for bulk mail, then the bulk mail rate of the postal administration should be the uniform postage rate (100) less the average collection cost (22), or 78 money units. For bulk mail delivered to the "most profitable" area, the bulk postal rate still includes a profit margin for sustaining the geographic cross subsidy.

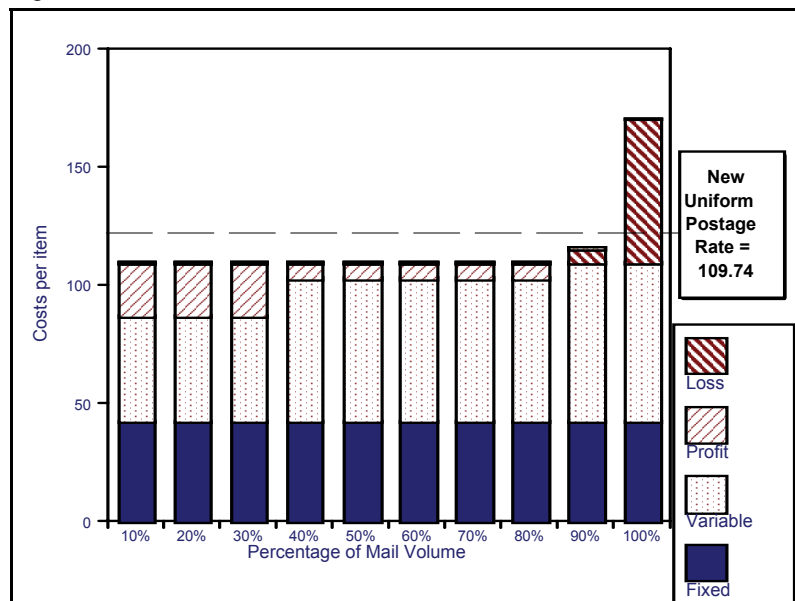
Figure 7 thus suggests that, under my assumptions, a relatively low cost cross border operator would have to achieve a mail volume of about one third of the current mail volume of the postal administration in order to be able to compete with a bulk mail rate offered by the postal administration in the same area.

5. A "WORST CASE" SCENARIO

Putting together these three elementary considerations—the structure of the cross subsidy, the moveability of mail, and the cost curve of the cross border operator—permits a rough quantitative evaluation of the effect of liberalisation of cross border mail on universal service.

First, my model suggests that it would be difficult for a cross border competitor to challenge a postal administration for domestic delivery even in the "most profitable" areas. According to my assumptions, only about one third of all mail is moveable to the cross border market. For reasons already noted, it seems likely that this fraction may be somewhat lower in the "most profitable" area. Even if it is not, a fairly low cost cross border operator would still have to get almost all of the potential market before he would have enough volume to reduce his prices to a level competitive with the bulk postage rate.

Figure 9. Worst case scenario for cross border liberalization



In actual operation, it would be impossible for a cross border operator to obtain all the bulk mail business immediately. Almost by definition, a bulk mailer is a sophisticated mailer who is commercially dependent upon the quality of postal service. A bulk mailer will therefore test a cross border service with small shipments rather than transferring all his business at once. Since the cross border market is (by hypothesis) competitive, test shipments would likely be divided among more than one cross border operator. It seems probable, therefore, that a cross border operator that wanted to compete for domestic bulk mail by undercutting the bulk mail rate corresponding to the uniform postage rate would have to anticipate a long period of losses at best, even in the “most profitable” areas. In short, under the my assumptions at least, it appears unlikely that cross border liberalisation poses any significant threat to domestic bulk mail.

Despite the implausibility of cross border competition, let us consider our quantitative model from the standpoint of a “worst case” scenario. Let us assume that, after some period of time, a cross border operator succeeds in capturing all of the domestic bulk mail to all of the “most profitable” areas. This amounts to 35 percent of all mail in the “most profitable” areas. Indeed, to give our “worst case” scenario an

extra measure of caution, let us suppose that the cross border operator diverts 50 percent of all mail currently delivered by the postal administration in the most profitable areas. What effect will such competition have on the ability of the postal administration to provide universal service?

Figure 8 shows the structure of the geographic cross subsidy after Post Office “A” has lost half of its most profitable mail. The total volume of mail will have decreased by 15 percent, half of all the mail in the “most profitable” areas. This loss would increase fixed costs for Post Office “A” from 36 to 39 percent of total costs.

In order to sustain the cross subsidy, Post Office “A” will have to raise its uniform postage rate from 100 to 109.74, almost a 10 percent increase. Ten percent is approximately the size of a normal postage rate increase. In simple terms, then, *the “worst case” effect of a cross border liberalisation under this quantitative model would be that, after an extended period of unsuccessful competition, a postal administration may have to advance the date of next normal postage increase.*

How plausible is this conclusion? In its comments on the Postal Green Paper, the British Post Office reported that, according to its studies, a loss of 50 percent of “local” traffic outside of London would imply an increase in postage rates of from 13 to 16 percent. A 25 percent loss of traffic would imply an increase of from 6 to 7 percent.⁷ Roughly speaking, then, my model appears to be consistent with the British model.

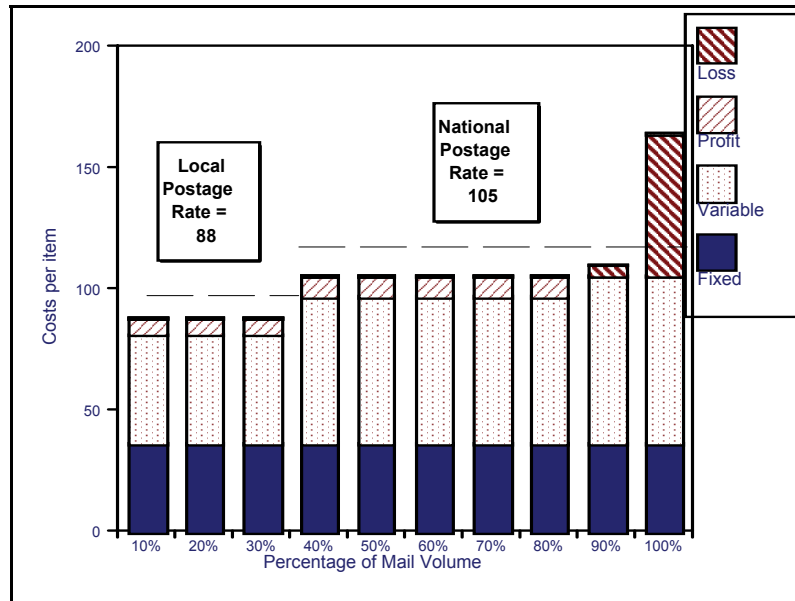
6. INTRODUCTION OF A “LOCAL” POSTAGE RATE

Not only does the model suggest that this “worst case” scenario is highly unlikely, it also suggests how Post Office “A” can reduce significant losses to cross border competition. If there are geographic areas in which the variable cost of postal service is substantially lower than the average, then cross border entry into these “most profitable” areas can be effectively blocked if Post Office “A” is willing to reconsider the uniform postage rate. It should be recalled that the uniform postage rate was introduced in 1840 by Rowland Hill as a cost based tariff reform. At that time, Hill calculated that long haul transport was an insignificant portion of total end to end postal costs. While this insight remains valid, it may be that, due to other factors, there is now a marked cost difference between local and national mail. If so, in the spirit of Rowland Hill, these differences should be reflected in the postage rates.

The quantitative model suggests that a “local” postage rate could be introduced for mail in the “most profitable” areas, while at the same time applying a uniform national rate for the rest of the mail. This could be done *without jeopardising the principle of affordable, universal postal service*. As Figure 9 shows, a two tiered postage rate would spread the cost of a geographic cross subsidy evenly among all letters. If the two postage rates bear the same relationship as costs in each geographic area, the “national” postage rate would be 105 money units and the “local” postage rate would be 88. Such a low, cost based local postage rate would substantially reduce, or block entirely, the possibilities for entry into the domestic bulk mail market by a cross border operator. It might also stimulate additional domestic mail for the postal administration.

⁷U.K. Post Office, “Response of the United Kingdom Post Office to the ‘Green Paper on the Development of the Single Market for Postal Services’” (21 December 1992) at 51. In reading this table, I have assumed that the rise in postage rates for a 50 percent loss in traffic and “good” post office cost recovery seems to be 13 percent instead of the 3 percent actually indicated. The “3” seems to be a typographical error.

Figure 10. Two tiered postage rates for Post Office "A"



7. CONCLUSIONS

It must be kept in mind at all times that the foregoing analysis is illustrative only. While the numbers used are not arbitrary, neither are they the numbers of an actual Member State postal administration.

As explained, in selecting numbers for my model, I have tried to give the defenders of the cross border postal monopoly the benefit of the doubt while still retaining an air of plausibility. It is possible, however, that I have not been generous enough, and that liberalisation of the cross border market would have a greater impact on universal service than calculated.

By the same token, it seems to me more likely that the effect of liberalisation would be substantially less than anticipated. I suspect that my model overestimates the actual cross subsidy experienced by most EC postal administrations. I also believe that this analysis fails to appreciate the practical difficulties that would be involved in the cross border printing and delivery of all, or even a large fraction, of domestic bulk mail. Cross border transport handicaps the cross border operator not only in terms of cost, but also in terms of time. This is likely to be a fatal competitive handicap for some items of bulk mail, such as invoices. I suspect, indeed, that remote printing of bulk mail is likely to be confined to the subset of bulk mail that is to be distributed on a genuinely EC wide basis. In the Single Market, however, such bulk mail should indeed have an EC wide printing and distribution network available to it.

Given these caveats, my analysis suggests that liberalisation of the cross border market is unlikely to have a major impact on universal service. A cross border operator would experience significant difficulties in achieving the economies of scale necessary to compete with a domestic postal service, even if the cross border focused on the delivery of bulk mail to the "most profitable" areas of postal service.

Even if this competitive threshold were passed, cross border operators are

unlikely to divert enough domestic mail to really undermine the potential for a geographic cross subsidy. Why? Because the pool of mail that can be diverted is necessarily limited. If the total cross subsidy is assumed to be a plausible fraction of total postal revenues (7 percent in my model), then either the cross subsidy is funded by a relatively small area where postal services are “most profitable” or the subsidy is spread more or less evenly across all non rural mail. In the latter case, the fact that the cross border operator does not have to contribute to the cross subsidy is cancelled by the cost of cross border transport. The cross border operator has no intrinsic advantage over the incumbent postal administration and has all the disadvantages of not having the postal administration’s economies of scale.

If, however, one assumes that the geographic cross subsidy is funded by extra profits that the postal administration earns in a few discrete areas—such as the central areas of cities—then “cream skimming” of domestic bulk mail may become theoretically possible, but only just barely so. Substantial cream skimming in this manner would likely take years to develop. More fundamentally, the total amount of mail involved would necessarily be small compared to the totality of mail. For this reason, in the worst case, diversion of the bulk mail in selected “most profitable” areas would likely require only relatively minor tariff adjustments. The postal administration might be required to advance the date of the next increase in the uniform postage rate. Alternatively, the postal administration might implement a “local” postage rate that reflected the lower costs of intra city postal service. A “local” postage rate would not jeopardize the maintenance of an affordable, universal national postal tariff.

Under the EC Treaty, neither of these “worst case” scenarios seems remotely adequate to justify a restriction on the free movement of goods and services between Member States. Monopoly restrictions on cross border services can be maintained only if it can be shown that, without them, postal administrations would have “no other technically feasible and economically attainable means of accomplishing their tasks”.⁸

Finally, but most fundamentally, I submit that the foregoing analysis indicates the need for quantitative analysis of postal opposition to cross border liberalisation. Only postal administrations have the necessary data. Postal claims that cross border liberalisation will undermine universal domestic postal service cannot be taken seriously without at least an attempt to provide the sort of quantitative analysis illustrated in this paper.

⁸See the opinion of Advocate General Da Cruz Vilaca in Case 30/87, *Bodson v. Pompes Funèbres des Régions Libérées*, 1988 ECR 2479 at paragraph 86.

2

Legal Definition of Universal Service (1995)*

On July 26, 1995, the European Commission approved a draft of a directive on Community postal services.¹ A fundamental element of the draft directive is adoption of a Community-wide definition for the universal postal service which all Member States will be obliged to ensure.

This paper considers the idea of how law has been used to define a universal service obligation in various postal and telecommunications sectors. The paper is concerned not so much with the specific details of universal service as with basic governmental questions such as who is obliged to provide the service and in what manner the obligations are specified. The paper cites several examples from postal and telecommunications sectors, primarily in the United Kingdom and United States. It is not intended to be a complete survey of the topic, but only to suggest that there are significantly different ways in which law has been used to promote universal service.

1. UNIVERSAL SERVICE AS A NON-LEGAL EXPECTATION OF A PUBLIC MONOPOLIST

The idea of using the law to relate an obligation to provide universal service to a grant of monopoly is a new idea, not a traditional one. Traditionally, a national post office enjoyed a monopoly without a specific legal obligation to provide universal service. As a legal matter, the two concepts are unrelated. Nonetheless, as matter of history, it is obvious that universal service came to be provided by postal monopolies. Indeed, it is probably fair to say that the postal monopolies *invented* the idea of universal service which has come to be supplied to all sorts of important

*Published as “The Legal Definition of Universal Service in Postal and Telecommunications Sectors” in *Cost of Universal Service*, WIK Proceedings Vol. 2, eds. Ulrich Stumpf and Wolfgang Elsenbast (Bad Honnef, Germany: WIK, 1996).

¹European Commission, Communication from the Commission on the Set of Measures Proposed for the Development of Community Postal Services (mimeo, July 27, 1995).

infrastructure services. Since the draft directive proposes to establish a legal relationship between the reserved area and universal service, it is useful to review briefly the historical development of universal service by the postal monopolies.

As an example of early postal legislation, one might look to Queen Anne's postal act, a postal law adopted in England in 1710. Queen Anne's act remained the basic postal law in England and North America until after the establishment of the United States in 1789. It repeated the postal monopoly prerogative first decreed by King Charles I in 1635 and repeated by Charles II in 1660. It also provided a long list of rules to govern the British Post Office. It did not, however, impose a universal service obligation in anything like the modern sense. The closest it came was a statement that the post office in London was to be a place from which letters could be sent to all parts of the British empire. There was no obligation to establish an office in cities or towns of any particular size, much less provide delivery to addressees. Queen Anne's act stated:

a General Post Office may be established for and throughout her Majesty's Kingdoms of Great Britain and Ireland, her Colonies and Plantations in North America, and the West Indies, and all other her Majesty's Dominions and Territories, in such Manner as may be most beneficial to the People of these Kingdoms. . . . there be thenceforth one General Letter Office and Post Office erected and established in some convenient Place with the City of London, from whence all Letters and Packets whatsoever may be with Speed and Expedition sent into any Part of the Kingdoms of Great Britain and Ireland, or to North America, the West Indies, or to any other part of her Majesty's Dominions and Territories, or unto any other Kingdom or Country beyond the Seas, at which said Office all Returns and Answers may be likewise received²

The concept of universal postal service evolved slowly during the second half of the nineteenth century. The initial impetus was of the revolutionary reform of the British Post Office introduced in 1840 as a result of proposals by Rowland Hill. Even so, delivery of mail to addresses was not widespread in England until the late 1850's. Delivery to every house, often only two or three times per week, was not achieved until about 1900.³ Although progress towards universal service was no doubt encouraged, even ordered, by ministers anxious for popular acclaim, universal postal service was fundamentally a response to the evolving needs and capabilities of society rather than a formal legal obligation.

Since universal service did not evolve as a legal obligation, traditional national postal laws are vague, at best, in describing the scope of universal service obligations. The French Post and Telecommunications Code of 1962, for example, sets out the scope of the postal monopoly as spelled out in the first two articles, but

²Anne c.10 (1710).

³See H. Robinson, *The British Post Office: A History* (1948; reprint, Westport, Conn.; Greenwood Press, 1970) at 357-58; M.J. Daunton, *Royal Mail: The Post Office Since 1840* (London: Athlone Press, 1985) at 44.

makes no mention of service obligations.⁴ In 1989, as part of a review of the laws prompted by the Green Paper study, a lawyer for La Poste admitted, “To our knowledge, the exact content of the public mail service is not foreseen by any text”.⁵ The nearest thing he was able to identify as a universal service law was a provision in the Post Office’s administrative regulations which states: “The [postal administration] collects correspondence objects whose transport it has been entrusted with and delivers these objects on all working days to the address indicated by the sender”.

In 1969, the United Kingdom initiated a second great round of postal reforms by making the British Post Office a more or less autonomous and commercially oriented government agency. At this time, the British Post Office Act of 1969 provided a slightly more formal universal service obligation stated as follows:

It shall be the duty of the Post Office . . . so to exercise its powers as to meet the social, industrial and commercial needs of the British Islands in regard to matters that are subserved by those powers and, in particular, to provide those Islands (save in so far as the provision thereof is, in its opinion, impracticable or not reasonably practicable) such services for the conveyance of letters and such telephone services as satisfy all reasonable demands for them. [§9]

The current British postal law, enacted in 1981, gave the Post Office an added measure of commercial freedom by separating it from British Telecommunications. Its “universal service” obligation, however, essentially repeated the 1969 law.⁶

In short, the concept of universal service at the end of the nineteenth century and the early twentieth century more as an expectation of “best efforts” rather than as a specific legal concept. As post offices have acquired a more independent orientation in the last several decades, this expectation has become embodied in law. Nonetheless, the postal laws do not generally impose specific universal service obligations. They do not, for example, require uniform national postage rates or a minimum number of deliveries per week. They do not even require service to addresses if such service is judged to be impracticable by the post office.

2. UNIVERSAL SERVICE AS A GENERAL MANDATE OF A REGULATOR

In Europe, the telephone industry developed as part of the public postal service. In the United States, however, telephone service was provided by private companies. In 1907, about one half of telephone service was provided by the dominant firm, American Telephone and Telegraph (AT&T) company, and half by independent telephone companies. Although the United States tried to preserve the quality of service by means of the competition laws by skillful use of patents and mergers, AT&T gained control of about 80 percent of the telephone business by

⁴Decree of March 12, 1962, Articles L.1 and L.2.

⁵F. Braize, “Les perspectives d’évolution de l’organisation juridique du marché du courrier: de l’ère des objets à l’ère des services?” in *Bulletin de l’IREPP* (March 1989) at 163.

⁶British Telecommunications Act 1981, 1981 chapter 38, sec. 59.

1934. AT&T's effective monopoly was not legally protected, but it was a monopoly nonetheless.

In 1934, the United States established the Federal Communications Commission (FCC) to define and enforce what today would be called universal service obligations on the telephone sector. The law gave the FCC the following mandate:

For the purpose of regulating interstate and foreign commerce in communication by wire and radio so as *to make available, so far as possible, to all the people of the United States a rapid, efficient, Nation-wide, and world-wide wire and radio communication service with adequate facilities at reasonable charges*, . . . there is created a commission to be known as the "Federal Communications Commission". . . . which shall execute and enforce the provisions of this chapter.⁷

The provisions of law to be enforced by the FCC included requirements:

- to provide telephone service "upon reasonable request" including service requested by other telephone companies (47 USC 201(a));
- to charge "just and reasonable" rates which can be grouped into reasonable categories such as day and night rates, letter rates, commercial rates, press rates, etc. (47 USC 201(b));
- to avoid "unjust or unreasonable discrimination in charges, practices, classifications, regulations, facilities, or services" (47 USC 202);
- to avoid giving "undue or unreasonable preference or advantage to any particular person, class of persons, or locality" (47 USC 202);
- to provide transparency for all rates (47 USC 203);
- to respect the privacy of communications (47 USC 605);
- to maintain services to communities without discontinuance or reduction unless by permission of the FCC (47 USC 214); and
- to keep accounts according to a uniform system prescribed by the Commission and accessible to the Commission (47 USC 219) and to make periodic reports (47 USC 220).

The FCC was authorized to judge whether or not telephone services complied with these conditions and to prescribe rates where necessary (47 USC 205). More importantly, the FCC was also authorized to license new telephone companies. With this power, the FCC had discretion to ensure universal service by means of an internal cross-subsidy earned by a reserved service provider or by means of external cross-subsidies extracted from competitive operators.

In the 1970's, microwave technology created opportunities for new types of telecommunications operators. Under pressure from the courts, the FCC licensed these new operators and required AT&T to connect with them so that they could provide telephone services to the general public without having to provide universal service individually. AT&T responded to these developments by using various

⁷47 USC 151.

tactics to hinder its competitors, including predatory pricing of competitive services, withholding cost information from the Commission, denying FCC jurisdiction over interconnection issues, and finding technical reasons to deny interconnection with AT&T facilities. These tactics were challenged by the Department of Justice which argued that AT&T was systematically violating the competition laws. In 1982, however, the courts agreed and ordered the company broken up into a long distance company and a series of local operating companies as of January 1, 1984.

Historically in the United States, long distance telephone service was overcharged in order to subsidize local telephone service and local service, in turn, was expected to be as inexpensive and universal as possible. The emergence of competition in the local distance market undercut this traditional cross-subsidy for universal local service. To preserve universal service, the FCC, in effect, required long distance companies to pay a tax into a Universal Service Fund. The Fund was used to underwrite the costs of subsidies for the local companies where they provided services to poor or rural customers. Otherwise, local telephone companies were allowed to increase charges to reflect actual costs.

The legal approach towards universal service in the U.S. telephone sector was thus fundamentally different from that employed in traditional postal laws even though both the U.S. telephone and postal sectors were dominated by effective monopolists. In the telephone sector, the obligation of universal service was placed on a regulator rather than a public monopolist. The requirements of universal service were specified as general legal principles—such as requiring reasonable rates without unreasonable discrimination—rather than left to the judgement of the public monopolist. Although, general principles may seem to be hardly more specific than the conduct that may be justly expected of a public monopolist, they acquired greater force because they were enforceable by a independent regulator. Most importantly, by subjecting the telephone industry to the competition laws and creating the possibility of additional licenses, the law and changing technology sowed the seeds of a transition to a more deregulated environment. Changing technology and the judicial review has encouraged, indeed forced, the independent regulator to recognize that universal service can best be ensured through a competitive market that is supplemented by a system of external, transparent subsidies.

3. UNIVERSAL SERVICE AS A LEGAL OBLIGATION DIVIDED BETWEEN PUBLIC MONOPOLIST AND REGULATOR

In 1970, the United States revised the laws organizing the national postal system. The U.S. Postal Service was obliged to provide universal service, but only in general terms. The universal service obligation of the US Postal Service is to:

- provide adequate and efficient postal services;
- employ reasonable rates and fees;
- serve as nearly as practicable the entire population of the United States;⁸

⁸39 USC 403(a).

- provide a nationwide uniform rate for letters,⁹ books, films, and educational materials;¹⁰
- avoid undue or unreasonable discrimination among users of the mails¹¹;
- transparency for rates and costs.

In effect, the 1970 act also placed part, but only part, of the obligation to ensure universal postal service on the back of an independent regulator, the Postal Rate Commission. The Postal Rate Commission has no control over the geographical extent of service, the level of postage rates, or the quality of postal services. The Postal Rate Commission does, however, have authority to block the Postal Service rates and classifications that discriminate between mailers. The law makes clear that rates should cover all marginal costs and a fair share of overhead costs, where the definition of a “fair share” is regulated by the Postal Rate Commission. In monitoring rate discrimination, the Postal Rate Commission also polices the transparency of cost and rate data. Finally, the Postal Rate Commission must be consulted for an advisory opinion before introducing major changes in service standards.¹²

Thus, the legal approach to universal postal service reflected in the 1970 act is a mixture of the non-legal expectations of a public monopolist and legally defined principles which an independent regulator is ultimately obliged to enforce.

4. UNIVERSAL SERVICE AS A LEGAL AGREEMENT BETWEEN GOVERNMENT AND ITSELF

Another approach towards the legal definition of a universal service obligation is to adopt the position that an operator owned by the government may act commercially subject to the conditions of a “contract” with or “license” from the government.

In 1984, the United Kingdom replaced its public telecommunications monopoly with a license scheme. One license was granted to British Telecommunications, which had been restructured as a company 49 percent of which was still owned by the government. A second license was granted to another operator, Mercury. Each license contained service obligations, although requirements in the BT license were greater than those in the Mercury license. According to its license, BT was required to provide telephone service “to every person who requests the provision of such services at any place in the Licensed Area”. BT was further required to provide interconnection with Mercury on fair terms. An independent regulator was established to ensure that license requirements were fulfilled.

BT’s licensing arrangement clarified the distinction between the governmental

⁹39 USC 3623(d).

¹⁰39 USC 3683.

¹¹39 USC 403(c).

¹²39 USC 3661.

self-interest and governmental protection of the general public interest. License conditions made more specific the universal service obligations which were deemed necessary to further the public interest. By removing the task of enforcing these public interest responsibilities from the Department of Trade and Industry, the absence of public interest considerations in DTI's remaining activities became more evident. Clarity did not always bring cheer, however. Many observers felt that it was apparent that DTI undercut the public interest objectives of the new legal scheme in order to increase the economic value of its shares and the revenue from those shares sold to the public as well as to protect its political stake in the continuing happiness of new BT shareholders.¹³

In 1987, New Zealand adopted a somewhat similar arrangement between the government and New Zealand Post, which was reorganized in 1987 as a limited liability company whose shares were owned by the government. Unlike in the case of BT, the corporatization act included a substantial reduction in the scope of monopoly enjoyed by New Zealand Post. The price limit on the postal monopoly (the price per letter above which private operators could carry letters) was reduced over a three-year transition period from NZ\$ 1.75 to NZ\$ 0.80, twice the basic stamp price. At the end of the transition period, it was expected that the monopoly would be abolished. A successor government, however, delayed termination of the postal monopoly for political reasons. To protect universal postal service, the government concluded a "deed of understanding" under which New Zealand Post agreed to maintain universal service, meeting certain quality standards at prices which were limited by a price cap reflecting the rate of inflation less two percent.¹⁴

Somewhat similarly, Sweden reorganized its post office in a series of steps beginning in 1989. Sweden, however, began the process by abolishing the postal monopoly altogether. In 1994, Sweden enacted legislation to reorganize the post office as a limited liability company and deal with the issue of universal service. The legislation explicitly charged "the government or authority appointed by the government", not Sweden Post, with responsibility to "ensure that the postal and counter services are commensurate with the needs of society" (§2). The legislation included a minimal definition of universal service:

there shall be a nationwide postal service enabling letter and parcels to reach everyone, irrespective of address. It shall be possible for everyone to have letters conveyed at uniform and reasonable cost. Private individuals shall also have an opportunity to have parcels conveyed at uniform cost. (§1)

To fulfill its universal service obligation, the Swedish government negotiated

¹³ See, e.g., C. Veljanovski, ed., *Privatization and Competition* (London: Institute for Economic Affairs, 1989), pp. 30-32. After five years experience with the act, the author notes that in theory both the independent regulator and the Secretary of State for DTI were statutorily obliged "to maintain and promote effective competition" and concludes that the "clear evidence . . . is that the Secretary of State has failed to carry out this duty".

¹⁴E. Toime, "Competitive Strategy for New Zealand Post" in M. Crew and P. Kleindorfer, *Competition and Innovation in Postal Services* (Boston: Kluwer Academic Publishers, 1991).

an agreement with Sweden Post. The agreement includes standards for delivery frequency, price caps for some services, and commitments to maintain rural post offices in return for compensation. The agreement lasts for three years (through 1996), after which the government may reconsider how it maintains universal service.¹⁵

These three examples—British Telecommunications, New Zealand Post, and Sweden Post—illustrate the idea of using a specific agreement between the government and an independent operator to define and assure universal service. The examples also represent a range of possibilities within this idea. In the case of BT, the license conditions are, in a sense, dictated by the government as a condition of operation rather than negotiated. BT has no choice but to accept. On the other hand, the BT example also exposes clearly the government's essential conflict of interest in the transaction. The UK has tied the hands of its own negotiators by preventing any more than one competitor to BT and by owning almost half the shares of BT. At the other end of the range, the government first created the possibility of real options for itself and Sweden Post by abolishing the monopoly and then negotiated a more or less arm's-length agreement to ensure universal service. Even in the case of Sweden Post, however, one cannot help suspecting that the government's ownership of Sweden Post may affect future negotiations if universal service contracts become more valuable and important to commercial fortunes of the operators which win them. Similarly, it seems reasonable to suppose that the board of Sweden Post must take some account of the desires of its owner in making management decisions. In all of these examples of the government making a deal with itself, there is an incomplete separation between the duty to ensure universal service and the commercial operations of the postal sector.

5. UNIVERSAL SERVICE AS A LEGISLATIVE MANDATE: EU TELECOMMUNICATIONS

During the last few years, both the Community and the United States have reviewed their telecommunications laws and resolved to provide specific *legislative* direction for universal service and, at the same time, to allow greater scope for competition. In both the Community and the United States, these two reforms are seen as interrelated.

5.1 REASON FOR THE UNIVERSAL SERVICE DEFINITION

In November 1993, the Commission sent a communication to the Council setting out the need for a definition of universal service in the telecommunications sector. The Commission explained the relationship between a more competitive telecommunications market and the need for a Community-wide definition for universal telecommunications service in the following terms:

¹⁵T. Zillen, "Sweden Post: Public Operator on a Deregulated Market" in Euroforum conference, "The Liberalization of the European Postal Services" (Amsterdam, 8-9 December 1994).

As long as telecommunications services were provided under direct State authority and as long as the TO, in dealing with users, benefited from certain legal immunities under national law, a definition in general terms, even though imprecise, of the notion of universal service could appear to have been sufficient. *As the traditional operators become increasingly independent and once the market is opened on the basis of free competition to new operators, it is necessary to determine the principles according to which the cost of universal service obligations can be shared amongst market participants. A clearer definition of universal service principles is vital to this process.*¹⁶

In short, the Commission concluded that a universal service definition is necessary to guide the apportionment of the cost of universal service fairly among operators in a competitive market.

5.2 SCOPE OF UNIVERSAL SERVICE

The Council responded in February 1994 with a Resolution¹⁷ calling upon *Member States* “to establish and maintain an appropriate regulatory framework” to ensure universal service. According to the Resolution, the basic idea of universal service is to ensure telecommunications services, especially telephone services, are available “to all users everywhere and, in light of specific national conditions, at an affordable price”. Universal service should be provided in accordance with the principles of “universality, equality, and continuity”. In its present form, at least, the universal service definition does not include a requirement of equal treatment¹⁸ for similarly situated users; indeed, the Commission’s implementing statement envisions “tariff flexibility i.e., the possibility of special and targeted provision for socially desirable purposes”. The same statement stresses the importance of “unbundled” tariffs as part of the universal service. In order to maintain quality of service, the Resolution contemplates reliance on publication of quality of service targets and the public reports on the extent to which those targets are met.

5.3 RELATIONS BETWEEN OPERATORS

A central element in the adaption to a more competitive telecommunications infrastructure is the idea of *interconnection* between telecommunications operators. In the Resolution stated, the Council recognized:

that in order to promote Community-wide telecommunications services there is a need to ensure interconnection of public networks and, in the future

¹⁶European Commission, “Developing universal service for telecommunications in a competitive environment”, COM(95)543-final (Nov. 15, 1993), p. 7.

¹⁷Council Resolution of 7 February 1994 on universal service principles in the telecommunications sector, 94/C 48/01, O.J. C48/1 (Feb. 16, 1994).

¹⁸According to the Commission’s Communication, “equality” refers not to equal treatment of similar users but “access independent of geographic location”. European Commission, “Developing universal service for telecommunications in a competitive environment”, COM(95)543-final (Nov. 15, 1993), p. 19.

competitive environment, interconnections between different national and Community operators.

With interconnection, new services will immediately add to the total telecommunications infrastructure available to the Community. Each new service will provide not only its own services but resell the capabilities of the existing infrastructure; similarly, existing infrastructure users will gain access to the new service.

In order for interconnection to expand the infrastructure, however, the existing telecommunications operator must set interconnection charges at reasonable and cost-based levels. If an existing telecommunications operator denies interconnection or sets interconnection charges too high, it can prevent a new operator from competing with the existing operator, even if the new operator provides a better or more efficient service. For this reason, the Commission announced in 1991 that it would strictly interpret the competition rules of the EC Treaty which govern agreements between telecommunications operators and prohibit cross-subsidy of competitive services with revenues earned from reserved services.¹⁹

5.4 FUNDING UNIVERSAL SERVICE

Since the motivating force behind the development of a universal service definition was the need to identify and apportion the costs of universal service among competing operators, the Resolution noted at the outset that one of its primary purposes was to provide “assistance in achieving the goal of universal service in a competitive environment . . . by setting out the major elements constituting universal service at Community level and by providing guidance as to the principles to be applied in financing of universal service”.

Within an infrastructure of interconnected telecommunications operators, the Resolution noted that universal service may be financed by

internal transfers, access fees or other mechanisms which take due account of the principles of transparency, non-discrimination and proportionality, *while ensuring compliance with competition rules* in order to make a fair contribution to the burden which the provision of universal service represents.

While this passage notes the continuing possibility of financing universal services by means of internal cross-subsidies, provided they comply with the competition rules, the primary funding mechanism is clearly “access fees”. Like the American FCC, the Commission also concluded that the cost of interconnection should include an “access fee” to compensate the existing infrastructure for the cost of the universal service obligation which it bears. Both ensuring a fair price for interconnection and calculating a proper access charge implies reliance upon a careful accounting of the costs of maintaining the infrastructure. As the Commission noted, one of the first priorities in adjusting to a more competitive environment is

¹⁹See, European Commission, Guidelines on the Application of the EEC Competition Rules in the Telecommunications Sector, 91/C 233/__, O.J. No. C233, 9.6.1991.

“establishment of transparent accounting principles and cost-allocation procedures for operators, in order to establish the real costs of maintaining and developing universal service”.²⁰

The Community approach to universal service in the telecommunications sector is still incomplete. The 1994 Council Resolution required the Commission to propose a detailed plan for ensuring universal service by the beginning of 1996.²¹

6. UNIVERSAL SERVICE AS A LEGISLATIVE MANDATE:
US TELECOMMUNICATIONS

Like the Council and Commission, the U.S. Congress is also in the process of developing specific legislative guidelines for universal service in a more competitive telecommunications sector. Although, as described above, the FCC and courts have virtually deregulated the long distance telecommunications market, local distribution of telephone calls has remained largely in the hands of regional monopolists, the “baby Bells” created by the breakup of AT&T in 1984. The problem of defining universal telephone service in the United States therefore closely parallels that in the European Union where distribution of local telephone calls has been controlled by *national* telephone monopolists.

Like the Commission, Congress’s starting point is recognition that the need for an explicit universal service definition is driven by the increase in competition in the telecommunications sector. The Senate committee has declared:

The clear statutory requirements for universal service in new section 253 are intended to provide continued consistency between Federal and State actions to advance universal service, and for *greater certainty and competitive neutrality among competing telecommunications providers* than the existing implicit mechanisms do today.²²

The language of the bill does not presume any particular existing mechanism for universal service must be maintained or discontinued; however, the Committee intends that *the universal service support mechanism implemented under new section 253 shall be, to the extent possible consistent with the goal of ensuring universal service, transparent, explicit, equitable and nondiscriminatory to all telecommunications carriers*. Because the existing support system relies to a significant extent on nontransparent internal cost-shifting by monopoly providers, the Committee expects the Joint Board will recommend appropriate transition mechanisms. . . .²³

The evolving American approach to ensuring universal service is similar to

²⁰European Commission, “Developing universal service for telecommunications in a competitive environment”, COM(95)543-final (Nov. 15, 1993), p. 10.

²¹European Commission, “Theme Paper: Universal Service Issues” (Sep. 19, 1995).

²²U.S. Congress, *Telecommunications Competition and Deregulation Act: Report of the Senate Committee on Commerce, Science, and Transportation on S. 652*, S. Rpt. No. 104-23, 104th Cong., 1st Sess. (Mar. 30, 1995), p. 25.

²³*Id.*

that emerging in the Community. The draft U.S. legislation obliges the FCC and the States to ensure universal service in the telecommunications sector. The legislation defines universal service in terms of basic principles such as the provision of service at “just, reasonable, and affordable rates” to “all regions of the Nation”. The American legislation establishes new, specific rights of interconnection and requires transparent accounting. The draft legislation continues and extends the authority of the FCC and States to levy “access charges” to finance the cost of universal service. Like the Commission’s Guidelines, the draft legislation explicitly prohibits cross-subsidy from monopoly services to competitive services.

7. UNIVERSAL SERVICE AS A LEGISLATIVE MANDATE: EU POSTAL SERVICES

In the Community, the Commission is also considering legislation to specify a universal service definition for postal services.

7.1 REASON FOR UNIVERSAL SERVICE DEFINITION

In the draft Communication²⁴ accompanying the draft directive on postal services, the Commission notes that the purpose of the draft directive is “a comprehensive approach for establishing . . . a universal postal service and gradual liberalization and opening up of the postal market to more competition” (§3). However, unlike in the telecommunications sector, the memorandum does note that the role of the universal service definition is to provide a means for identifying and fairly apportioning costs of the universal service obligation among competing operators. Rather, the draft Communication explains:

In order to ensure the financial viability of the universal service, the proposed Directive defines harmonised criteria for the service which may be reserved for the universal service providers to the extent necessary for the maintenance of the universal service §(4)

In other words, in the postal sector the definition of universal service serves not to establish the extent of a financial burden to be fairly distributed among operators but the extent of a financial burden which may be used to justify a reserved area. Nonetheless, the Explanatory Memorandum accompanying the draft directive stresses the importance of allowing universal service providers “commercial, operational and financial independence needed to ensure efficient compliance with customer requirements and technological developments in an increasingly competitive environment” (§7).

The draft Explanatory Memorandum accompanying the draft directive explains the opening up to more competition in the following terms:

The maintenance of a reserved sector must be compatible with the objective of a gradual opening-up of the postal market to competition in accordance with

²⁴“Communication from the Commission on the Set of Measures Proposed for the Development of Community Postal Services” (mimeo, July 27, 1995). To date, the Communication has not been published or officially sent to the Council.

the rules of the Treaty. *If Member States are obliged to guarantee the financial viability of the postal operators responsible for providing the universal service, they are equally obliged to comply with Community law* and, in particular, the rules on competition, pursuant to the principle of proportionality.

The quoted passage why the universal service definition should play a different role in the telecommunications and postal sectors. The Community's investigation of postal services uncovered no relationship between the scope of the universal service obligation and the scope of the reserved area or any reason to be believe that universal service could not be ensured by identifying and apportioning the cost among competitive operators, as proposed in the telecommunications sector.

7.2 SCOPE OF UNIVERSAL SERVICE

As in the draft definition of universal service in the telecommunications sector, the draft directive on postal services proposed to place the obligation for maintaining universal service on the Member States. However, unlike in the telecommunications sector, Article 4 of the draft directive on postal services states that "Member States shall designate one or more postal operators to be responsible for providing universal service". Similarly, Article 9 states that "Member States shall designate the entity or entities that are entitled to place letter-boxes on the public highway". Thus, in the postal sector, universal service implies "universal service providers" designated by the Member States whereas universal telecommunications service does not necessarily envision such a class of operators.

In addition to requiring all Member States to ensure postal services for all users at affordable rates, Article 4 of the draft directive includes fairly strict criteria for universal postal service: "good-quality" door to door service at least 5 days per week for all addressed items up to 20 kilograms. At its discretion, a Member State may define the universal service to require that tariffs for universal postal service should be not merely affordable but uniform throughout the territory.²⁵ The Member State is directed to ensure the inviolability and secrecy of correspondence and ensure that universal service providers "offer an identical service to users under similar conditions" and "without any form of discrimination whatsoever, especially without discrimination arising from political, religious or ideological considerations" (Article 5).

7.3 RELATIONS BETWEEN OPERATORS

The draft directive does not place any emphasis on interconnection in the same manner as the draft definition of universal service in the telecommunications sector. Article 14 of the draft directive declares that "Member States shall take steps to ensure that terminal dues are determined in relation to costs". This provision applies only to charges between universal service providers.

²⁵This provision appears to expand substantially the extent to which a universal service obligation can be used to justify a reserved area.

In addition, in contrast to the telecommunications guidelines of 1991, the Draft Notice on the Application of the Competition Rules to the Postal Sector, a companion to the draft directive, announces a less strict approach towards cross-subsidy from the reserved services to competitive services. While the telecommunications guidelines require that “all products and services should bear proportionally all the relevant costs, including costs of research and development, facilities, and overheads”, the draft notice allows a post office to cross-subsidize competitive services from monopoly revenues when justified by “the cost of universal service obligations”. The only limit is that the price of competitive services must cover at least the “average incremental cost”. In other words, in competing with private operators, a post office may use the postal monopoly to pay for its “fixed costs”.

7.4 FUNDING UNIVERSAL SERVICE

The draft directive envisions internal cross-subsidy by the universal service provider as the primary means of funding universal service. In addition, Article 10 provides that a Member State may establish licenses for private operators, whether within the universal service or not, and impose universal service obligations or universal service assessments as conditions for such licenses. However, such obligations should be proportional and the Member State must ensure that such charges adhere to the principles of transparency, non-discrimination and proportionality. The draft directive does not identify access fees as a specific source of funding for universal service.

8. CONCLUSION

All universal service obligations are not created equal. There are substantial differences among the types and effects of legal obligations to provide universal service. A legislator, therefore, must consider carefully before adopting a particular legal formula to satisfy the universal desire for universal service. In particular, a legislator must consider carefully which government agency is to be vested with the legal obligation to ensure universal service, and the role that the universal service obligation will play in the overall legislative scheme.

3

Evolution of the Postal Function in Long Distance Markets (1997)*

This paper suggests that, as a consequence of improvements in long distance technologies, governments that seek to facilitate their citizens' participation in international commerce should negotiate and conclude a convention that would allow and encourage the development of *international postal systems*, that is undertakings—regardless of ownership structure—that are capable of providing international postal services with the same simplicity and managerial control that domestic postal systems can exercise at national level. Such a convention would represent a fundamental departure from the current international legal framework, which restrains the development of international postal systems by means of a tangle of national postal monopoly and customs laws reinforced by the Universal Postal Convention of 1874.

To support this thesis, I begin by reviewing the manner in which changes in technology have led to changes in the “postal function” at national level, that is, the economic and social role played by public and private postal services generally. I suggest that changing technologies, together with the resulting changes in the market structure and legal structure, have led to a substantial stimulation of the postal function in the last quarter of the 20th century. A brief review of the postal function in international commerce suggests that, without fundamental reforms, those who participate in international commerce will not be able to participate in the economic benefits which an improved postal sector has brought to the national economies.

As used in this paper, the term “postal service” refers to regularly scheduled transportation of relatively small, specifically addressed objects from one place to another, whether operated by the government or by a private company. Different types of postal operators can be distinguished based upon the type of postal service

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they are seeking to optimize. One might be organized primarily to deliver letters, another to deliver parcels; one might specialize in local traffic, another in long distance service. For operational reasons, there is a tendency for different postal operators to specialize in different postal services, especially as total demand grows. The “postal sector” is the sum of all postal services provided by all postal operators.

1. EVOLUTION OF THE POSTAL FUNCTION AT NATIONAL LEVEL¹

A good place to start thinking about evolution of the postal function is to consider life before postal services when people gathered in villages so that they could be physically in each other’s presence. In the local village, the visitor could gossip with neighbors or converse with travelers to learn the latest news of events near and far. He might buy goods manufactured in town or imported from other places or announce his readiness to sell crops or pelts. The visitor might record a transfer of deed or proclaim the marriage of his son or daughter. Before postal services, a visit to the local village was the only way an ordinary person in everyday life could interact with the world outside his immediate household.

The ordinary person did not acquire the capability to place a letter or object in the hands of a specific person living in the same country until the development of modern national post offices in the mid-19th century. National post offices were the product of several centuries of commercial development. The first postal systems for non-governmental dispatches were organized as private messenger systems for merchants, universities, and monasteries in 15th century Europe. National postal systems open to the public commenced in France and England in the 16th and 17th centuries. National postal services were prohibitively expensive for ordinary correspondence until, in 1840, the British Parliament adopted a series of reforms advocated by Rowland Hill. British postal reforms were soon copied by other nations. For society as a whole, these postal reforms marked the first time that personal human interaction at a distance became possible.²

In the United States, as in England, the function of postal systems prior to the Industrial Revolution was to provide long distance communications by conveyance of letters and newspapers. Although the ability to communicate at a distance made a powerful impact on society, it took several decades of postal evolution before an American citizen could correspond with anyone in the country or purchase goods at a distance. Most letters were probably carried by private messengers until relatively affordable postage rates were introduced by the Post Office in 1845. Local, intra-city postal services were begun by private postal services in the 1840s; the Post Office

¹I use the postal history of the United States to exemplify changes in the national postal function that, I believe, are broadly representative of the experiences of all developed countries.

²Rowland Hill urged lower and simpler postage rates based upon costs, i.e., without a markup to boost tax revenues. He also proposed reducing postal costs by a host of administrative simplifications including rates based on weight (instead of the numbers of sheets in a letter) and prepayment of postage by the sale of adhesive stamps (instead of collecting postage from the addressee upon delivery). *See generally*, Dauton, *Royal Mail*; Harlow, *Old Post Bags*; Scheele, *Short History*.

did not begin local service until 1863. A uniform national postage rate was not introduced until 1883. Postal delivery to rural areas, where more than 60 percent of Americans lived, was not started until 1896; as late as 1917, 20 percent of rural population still did not have postal delivery.³

The capacity to buy, sell, and exchange physical items at a distance was developed slowly by private “express” companies who exploited the possibilities offered by the railroads, which first appeared as primitive devices in the 1830s.⁴ So far as the postal function was concerned, the key virtue of the railroad was that it substantially improved the speed and lowered the cost of long distance transportation relative to local transportation. By adding a pickup and delivery service to the railroad, it became almost as easy for a central supplier to deliver a few goods to specific individuals as it was to deliver a cargo of goods to a local store. It took roughly four decades for the railroad system to become sufficiently widespread and inexpensive to sustain long distance distribution of individually addressed parcels. The first “mail order” company was started in 1872 by Montgomery Ward in Chicago to serve farmers in the central and western United States. Extension of the Post Office’s services to rural areas beginning in 1896 was a boon to postal services devoted to parcel delivery because it allowed mail order companies to correspond with rural residents who were especially eager to buy goods at a distance.⁵

In this manner, the scope of the postal function grew from merely providing the capacity for communications at a distance to providing the capacity for complete transactions at a distance. This enlarged postal function was developed through the complementary efforts of the official Post Office and the express and transportation companies. The government, however, later enlarged the mission of the public Post Office to include most of the postal function. In 1872, the postal monopoly was extended to include the local letter distribution begun by private companies. In 1912, the Post Office was authorized to begin parcel post service over the protest of the express companies.⁶

In the 20th century, the expanding availability of new technologies modified and re-modified the social role of the postal sector. In the 1920s, the automobile sharply decreased the relative superiority of long distance transportation to local transportation. Local stores were easier to get to and able to offer more variety and

³ Roper, *The United States Post Office*, 145. In England, two to three day per week delivery to every house was not achieved until 1900, when correspondence reached 88 letters per person per year. Letter density was lower in France (52) and Germany (61), so universal service presumably took still longer to achieve, but I do not have comparable dates for these countries. Daunton, *Royal Mail*, 44, 81.

⁴ A good history of the private express companies in the 19th century is Harlow, *Old Waybills*.

⁵ Emmet and Jenck, *Catalogues*, 19. The mail order industry emerged in England at about the same time as in the United States; by 1888 one mail order house employed more than 100 clerks. Daunton, *Royal Mail*, 79.

⁶ Local merchants also protested Post Office entry into parcel post because they feared that parcel post would further enhance the ability of distant suppliers to compete with local stores.

later fashions than mail order catalogs. The mail order business declined and postal systems became relatively less important as conduits for conveying long distance parcels. As reliable and inexpensive local telephone systems evolved, postal systems became relatively less important as a means of maintaining letter-type communications.⁷ Telephones had advantages over postal systems in long distance communications as well, but they were so expensive that, for several decades, postal systems remained important as transmitters of long distance letter-type communications.

In the last quarter of the 20th century, the technology of long distance transportation again improved dramatically both in absolute terms and relative to local transportation. In this case, the key technology was not the railroad but the jet aircraft, especially the wide body jet aircraft introduced in the late 1960s. As in the last quarter of the 19th century, public and private postal systems facilitated competition between long distance suppliers and local merchants. Personal computers further enhanced the competitiveness of distant markets by making it easier to coordinate disparate activities, monitor changes in supply and demand, and target addressed advertisements. Moreover, as in the late 19th century, demand for long distance conveyance of specifically addressed items was stimulated by improvements in long distance communications. This time it was the evolution of cheap long distance telecommunications and television, rather than the spread of inexpensive postal systems, that made long distance communications easier. Indeed, improvements in telecommunications technology seemed to stimulate not only the traffic in telephone calls but also the demand for postal delivery of urgent documents.

As a result of these improvements in long distance technologies, the postal function again increased in relative importance in long distance markets. As in the 19th century, the marriage of the new technologies and the pick up and delivery function was pioneered by private companies, most notably Federal Express. The enhanced role of long distance postal functions was reflected in both commercial operations (“just-in-time” management) and consumer sales (“direct marketing”). Mail order firms again arose to challenge local merchants. In the late 20th century, the postal function gave the average American not simply access to basic goods at big city rates but access to the whole range of small and medium sized producers throughout the national market.

⁷The function of different types of written communications and the impact of telecommunications on postal services is, I believe, illuminated by a re-consideration of the visit to the local village. *Letters* corresponded to verbal conversations in the village. *Documents* embraced the types of records which would be written down even when two people were in physical proximity because of the need to preserve an accurate account of some important information. *Newspapers* and other printed publications corresponded to verbal announcements and stories that were communicated to many people. A roughly similar tripartite division of written communications may be traced through English and American postal laws back to their origins in the 17th century. In 1874, the first Universal Postal Convention explicitly divided written communications into “letters,” “printed papers,” and “commercial papers.”

The expansion of the postal sector implied by technological improvements was also reinforced by regulatory changes. Rather than expanding the scope of the public postal operator as it had at the end of the 19th century, Congress gave the Postal Service greater autonomy from the government and more freedom to act like a business and pressured the Postal Service into disclaiming any monopoly over the carriage of “time-sensitive” letters and documents. The capacity of the U.S. airline system to move cargo was enlarged by expansion of the industry following airline deregulation in the late 1970s. Similarly, improvements in the efficiency and capacity of the long distance telephone services in the United States were catalyzed by deregulation, in this case time by intervention of the courts in the late 1970s.

Changing technology and increased regulatory flexibility have not only increased the importance of the postal function but also changed the mixture of providers. Today, the postal function in the United States is carried out by a variety of public and private operators offering a diversity of complementary and competing services. Expansion of the postal sector has benefitted the public operator as well as private operators. Between 1960 and 1975, the volume of domestic postal items handled by the public postal operator in the United States increased 40 percent; between 1980 and 1995, while private postal operators blossomed, the Postal Service’s traffic increased 67 percent.⁸

2. EVOLUTION OF THE INTERNATIONAL POSTAL FUNCTION

The rise and development of postal systems in national commerce has been paralleled by the evolution of an international postal function. Indeed, the first postal systems—those established in the Middle Ages—were *international* postal systems, that is, their primary purpose was to transport and deliver letters addressed to specific persons in other countries.⁹ After the 17th century, these international postal systems were gradually closed as nations decided to prohibit the carriage of mail across their territories by any other than the national post office.

For this reason, when the British postal reform of 1840 and development of the railroad stimulated development of a greatly enlarged postal function over the course of the 19th century, there were no international postal systems to adapt these technologies to international commerce. Demand for international postal services was almost entirely satisfied by the exchange of written communications and parcels between *national* postal systems. This approach to the international postal function was solidified by the conclusion of a treaty in Berne in 1874 establishing a General

⁸The figures for all domestic postal items (billions of pieces) were: 1960: 63.7 (Post Office Department); 1975: 89.3; 1980: 106.3; 1995: 177.7.

⁹International messenger systems were established by universities in Paris, Bologna, Naples, Toulouse, Vienna, and Heidelberg, among others. Codding, *The Universal Postal Union*, 4. In Italy, merchants established inter city-state postal systems such as the courier service of Bergamo established in 1290 by Amadeo Tasso. Scheele, *Short History*, 21. Major monasteries also established international messenger systems. Harlow, *Old Post Bags*, 28.

Figure 1. Australia: mail, 1981-1995

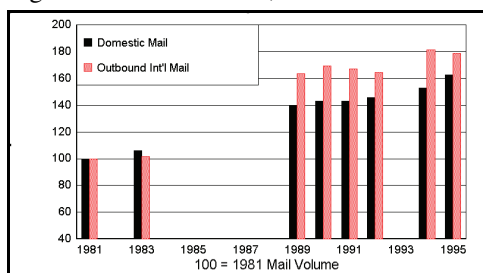


Figure 2. France: mail, 1981-1995

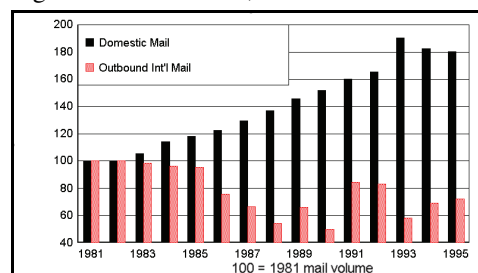


Figure 3. Germany: mail, 1981-1995

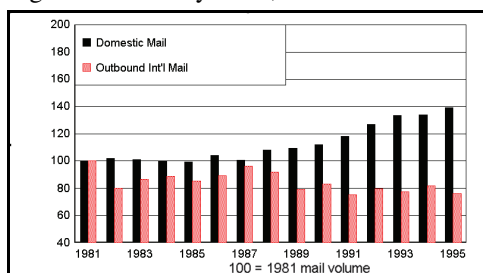


Figure 4. Japan: mail, 1981-1995

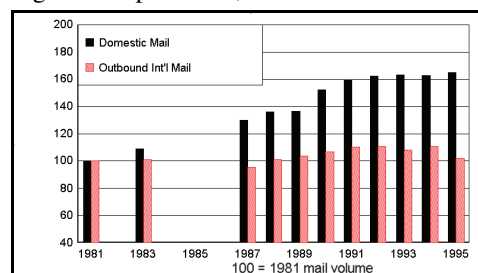


Figure 5. United Kingdom: mail, 1981-1995

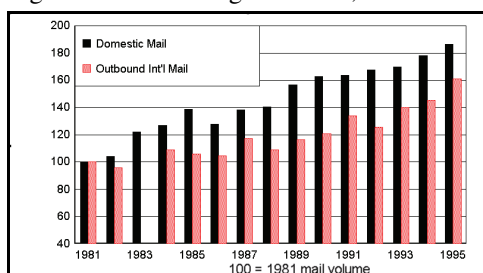
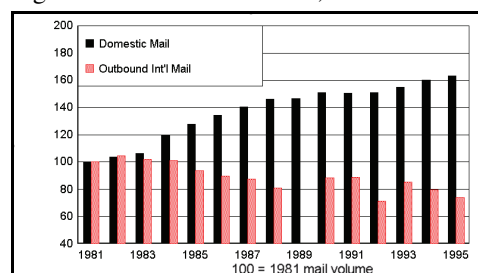


Figure 6. United States: mail, 1981-1995



Postal Union among 21 countries¹⁰ and the conclusion of a Parcel Post Convention by the (renamed) Universal Postal Union in 1880.¹¹

While its effects are difficult to quantify, formation of the UPU no doubt eased the exchange of written communications and parcels compared to preexisting international conditions. On the other hand, the balkanized nature of international postal service implied weaknesses as well. The UPU never truly applied the lessons of Rowland Hill to international postal services: cost-based rates, simplified tariffs, operational simplicity.¹² Individual post offices retarded development of international

¹⁰Codding, *The Universal Postal Union*, 25-34.

¹¹Codding, *The Universal Postal Union*, 43. Although it was signed by 19 countries, of the major post offices only Germany had a parcel system in place; the post offices of England, France, and the United States did not. Parcel post was started in France in 1881, in England in 1882, and in the United States in 1912.

¹²“International Postal Reform” goes through Hill’s 1837 argument for postal reform step by step and compares suggestions with the international postal services organized by the UPU.

Table 1. Letter post traffic of major post offices, 1981-1995

	Domestic LP (mil)			Outward LP (mil)			Out/Total LP	
	1981	1995		1981	1995		1981	1995
US	108,723	177,663	63%	878	647	-26%	0.80%	0.36%
Japan	14,680	24,263	65%	113	115	2%	0.76%	0.47%
Germany	13,660	19,000	39%	514	390	-24%	3.63%	2.01%
France	13,080	23,577	80%	491	354	-28%	3.61%	1.48%
UK	9,391	17,529	87%	493	793	61%	4.98%	4.33%
Australia	2,575	4,183	62%	102	183	79%	3.83%	4.19%
Totals	162,109	266,215	64%	2,590	2,483	-4%	1.57%	0.92%

Source: Universal Postal Union

postal services by maintaining especially high postage rates (compared to domestic rates) and by giving low priority to the dispatch and delivery of international postal items. Then, too, at inter-continental distances, transportation by ship was too slow to permit the development of international mail-order services in the same manner as railroads permitted in the domestic economies.

Deficiencies of international postal service were brought into high relief during the second great stimulation of the postal function in the last quarter of the twentieth century. A comparison of the growth of international and domestic letter post items (letters, documents, and printed papers) handled by public postal operators since 1915 (i.e., after the great expansion of long distance postal function due to the introduction of the railroad) suggests that, very roughly, traffic in international written communications grew at a pace similar to that of domestic written communications until about 1970. Thereafter (i.e., during the expansion of the long distance postal function by the introduction of jet aircraft), international letter post traffic fell substantially behind the pace set by domestic letter post. Between 1981 and 1995, domestic letter post mail in the United States grew by 63 percent; international letter post fell by 26 percent. In France, domestic mail grew by 80 percent while international mail fell by 28 percent. Germany likewise saw a decline in international letter post volume of 24 percent. The Japanese post office's international mail volume remained essentially flat (+2 percent). Of the major national post offices, only the U.K. Post Office saw a significant growth in international mail volume (61 percent), and even this was substantially behind domestic mail growth in the same period (87 percent). See Figures 1-6 and Table 1.

During the period when the international services of nationally-based public postal operators began to lag behind their domestic services, a new type of postal operator evolved to serve the international postal market: the international express operator. Led by DHL, the international express operators were the first true *international postal systems* to appear since the closure of the medieval messenger

systems. Like their domestic counterparts, international express operators were fashioned to take advantage of the new possibilities offered by jet aircraft and improved telecommunications. These companies also moved quickly to use of computer technology to introduce “tracking and tracing.” International express companies provided rapid and reliable international service because they specialized in international service and maintained their own offices in the countries served. The international express operators in effect circumvented the legal restrictions on international postal systems created by the national postal monopoly laws and reinforced by establishment of the Universal Postal Union. They were able to do so by successfully arguing that they provided a service that was needed by international business and was different in kind from that reserved to the national post offices.

While the rise of the private international express operators to some degree offset the decline in the international services of public postal operators, it seems clear that the international postal sector as a whole has not kept pace with the domestic postal sector.¹³ This failure is particularly noteworthy because the technologies that have driven and reshaped the expansion of the domestic postal function—long distance aviation and telecommunications—are as applicable to international commerce as much as domestic.

What are the reasons for decline in the international postal function? I believe the main causes lie in the failure of national governments to modernize the regulatory structure for international postal services in same manner as most have modernized their national regulatory laws. The contrast between the success of long distance domestic postal services and international express services, on the one hand, and the failure of international postal traffic generally, on the other hand, strongly supports this conclusion.¹⁴ Major public postal operators themselves appear to be convinced of this diagnosis and, as a partial remedy, are now moving to establish offices in other countries. Offices in multiple countries cannot, however, overcome the basic problem that the current international regulatory structure obstructs the ability of all operators to provide international services that are as rapid, reliable, and inexpensive as domestic postal services.

Two primary regulatory barriers may be singled out. First, of course, the patchwork of national postal monopolies has precluded the development of international postal systems that are comparable in efficiency to the services offered by good public post offices at national level. Second, customs laws have

¹³Although quantitative analysis is difficult, it does not appear that the rise of the international express companies explains the decline of the international public post. The international public post appears to have declined much more in some countries than in others, even though the international express operators seem to have been equally active in all. Moreover, express operators have been at least as active in domestic commerce as international commerce, yet the domestic traffic of the public operators has grown continuously.

¹⁴There are also other factors which inhibit international commerce, such the presence of cultural and language barriers. The globalization of many products, however, suggests that such considerations are not insurmountable over time.

substantially increased the time and cost of delivery international parcels, undermining the stimulative effect of improvements in long distance transportation and communications technologies. While the first impediment has probably fallen most heavily on public operators, the second has especially plagued the private operators. Regardless of who suffered most from which impediment, the international business of all types of operators has been retarded. As the growth of the domestic postal sector in the last two decades shows, different types of operators within the overall postal function are not only competitive, they are also synergistic.

3. A CONVENTION ON INTERNATIONAL POSTAL SYSTEMS

To reap the potential benefits of international commerce, the international economy needs a well-functioning and efficient postal sector just as in the domestic economy. To encourage development of an efficient international postal sector suited to the needs of modern commerce, a wholly different legal framework will be needed, one that is a mirror image of the 19th century structure. Instead of discouraging evolution of international postal systems, governments should encourage them. Instead of reinforcing the inhibiting effects of frontiers with elaborate customs requirements, customs formalities and tariffs need to be reduced to levels commensurate with taxes and regulations encountered in domestic commerce. With these objectives in mind, one might preliminarily imagine some of the elements that should be considered for inclusion in a “Convention on International Postal Systems.”

3.1 DEFINITION OF THE “POSTAL” TERRITORY

At the outset, a Convention on International Postal Systems will have to define the term “postal.” In 1874, when governments first tackled the idea of establishing an international postal territory, the scope of the “postal” sector was self-evident. “Postal” activities were activities provided by national post offices, essentially the regular exchange of letters and printed papers. Parcel delivery was not a “postal” activity, since the national post office was still considered primarily a medium for long distance communications. When national post offices expanded in competitive parcel services in the next decades, the objective meaning of “postal” became obscured. Today, the meaning of “postal” is even more problematic. Are worldwide express services of PTT Post, the privatized Dutch post office, “postal” services or not? Is the delivery of a software package to an end user a “postal” service? What about the delivery of email?

At the beginning of this paper, I suggested that the essence of a postal service lies in its operational nature—regularly scheduled transportation of relatively small, specifically addressed objects from one place to another—even though the function that this type of operation plays in society has shifted. Indeed, the introduction of new technologies has served to clarify the concept of “postal” systems by casting contrasts with related services. In light of the purely communicative nature of telecommunications, it is clear that postal services are not primarily communications systems but physical transport systems that have been, and still can be, used for

communications. In light of the rise of express services (both in the 19th century and again in the 20th century) it is more evident that a postal service is not simply a freight service for small items. The transmission of items which are specifically addressed, and therefore sent to their ultimate user, plays a different economic role than the periodic, bulk transmission of items which are stockpiled for later distribution. This difference remains, even though postal systems and freight distribution systems compete in the same way that mail-order distributors and local merchants compete.

For the purposes of an international treaty, a simple definition of “postal” items will be needed. As an example, one might imagine defining “postal items” to include items weighing up to 30 kilograms and valued up to 300 SDR (about US\$ 400). Thirty kilograms is more or less the weight limit for universal service obligations for national post offices and the weight limit used by some national express services; it could reasonably be set as lower (say, 20 kilograms) or higher (say, 70 kilograms). The value limit is taken from the upper value limit for the Universal Postal Union’s simplified customs form, the CN 22. Again, a higher or lower value could be defended, but, given the possibility of very large value commercial shipments contained in very small containers (for example, a box of computer chips), it would be difficult to dispense with a value limit altogether.

3.2 RIGHT OF ESTABLISHMENT

The foundation of a Convention on International Postal Systems must be the right of establishment. A national in any signatory country should have the right to establish an office of an international postal system in any other signatory country. From this office, the international postal operator would be able to collect or deliver international postal items sent to or delivered from any point in any other signatory country. A right of establishment implies a right to be free from legal discrimination which could favor some international postal systems over others. All laws, including competition laws, will have to apply equally to all operators.

The right of establishment for international postal systems implies a limitation, but not a disruption, of national postal monopoly laws. In general, the purpose (or at least the justification) of national postal monopolies is that they permit the knitting together of the national life by means of a uniformly priced, universally available national delivery system. These important national goals are not inconsistent with the development of international postal systems. International postal traffic is such a small enough fraction of national postal traffic that increased competition for international traffic will not seriously affect domestic postal services. In any case, the national postal system can be protected from the financial consequences of losing traffic to international postal systems by permitting signatories to tax international postal systems up to the level of domestic postage. In this manner, international postal systems will more than compensate domestic postal services for net losses due to diversion of traffic and will be unable to siphon domestic traffic into the international market. To avoid impairing the right of establishment, it will be necessary that any such domestic postage based be levied on all international postal

services including the international services of domestic operators.

3.3. RIGHT TO TRANSIT SERVICES

If the right of establishment is the bedrock of a Convention on International Postal Systems, the bedrock of the 1874 Universal Postal Convention was the right of each postal administration to obtain transit services from other postal administrations, that is, each signatory country was legally obliged to transport “transit” postal items across its territory to a neighboring country closer to their ultimate destination. Modern air transportation has rendered this right largely irrelevant. A public or private postal operator can arrange with international airlines for through transportation of postal items between any two countries. Nonetheless, it may be desirable to retain a basic legal obligation requiring each signatory country to provide for transit transportation at cost-based rates if no other transportation is publicly available.

3.4. RIGHT OF SELF-TRANSIT

A Convention on International Postal Systems should also include a new right of self-transit, that is, a rule that guarantees the right of an international postal operator to arrange for or provide for the transportation of postal items across the territory of signatory country, subject to compliance with essential safety and security laws. Such a provision would, in effect, exempt transiting trucks, ships, and aircraft carrying only postal items from licensing and other economic regulation. Such a provision could be modeled on the International Air Services Transit Agreement of 1944, an agreement that allows aircraft of signatory countries to fly over each others’ territory and land for non-traffic purposes.

3.5 RIGHT TO NATIONAL TREATMENT

International services will likely be required to “interline” postal items with domestic postal services on some occasions because domestic delivery services will enjoy economies of scale that international postal services will not be able to match. Given the historic practice of national post offices discriminating between domestic and international mail, a Convention on International Postal Systems should specifically prohibit interline discrimination based on the nationality of the operator. Accordingly, an international postal system should have access to retail and bulk domestic postage rates. Such a rule would still allow a domestic postal operator to surcharge a international operator that tenders large quantities of especially costly postal items (e.g., large quantities of rural mail) provided the domestic postal service applies similar surcharges to bulk domestic mailers.

3.6. RIGHT OF ACCESS TO PUBLIC POSTAL SERVICES WITH SPECIAL OR EXCLUSIVE RIGHTS

If the domestic postal operator is the beneficiary of a postal monopoly or other special legal rights, a Convention on International Postal Systems should go further and require a domestic operator to provide all international postal operators with the

same services for the same prices. This is a corollary to the right of establishment. If a signatory country could, by law, favor one or more international operators with access to domestic operators with special or exclusive rights, it could effectively impair the right of establishment of other international postal systems.

3.7. RIGHT TO SIMPLIFIED CUSTOMS CLEARANCE

Customs laws comprise the single most significant impediment to the development of modern international postal services. For this reason, customs law should become a major element of a Convention on International Postal Systems.

Existing laws dealing with the customs treatment of postal items are unsatisfactory. The Universal Postal Convention deals with customs issues as an ancillary matter, primarily by agreement on what purport to be customs forms for items carried by public postal operators. Customs procedures for postal items are set out in various sections of the International Convention on the Simplification and Harmonization of Customs Procedures (“Kyoto Convention”) administered by the World Customs Organization. In combination, these international laws imply substantially different customs procedures for identical shipments depending upon whether the shipments are tendered by public or private operators, and neither procedure is satisfactory. Customs treatment of public operators is derived from practices developed for the clearance of letters and printed papers. When applied to parcels, customs procedures for public operators are slow, burdensome for customs authorities, and enforced unevenly at best. Customs treatment of private operators is derived from the laws relating to customs clearance of freight. Although customs authorities have introduced some simplifications based mainly upon electronic processing of data, customs procedures for private operators remain far too expensive and complicated, especially when applied to documents and low value parcels. Overall, customs treatment of postal services distorts trade, retards development of the sector, and unduly burdens customs authorities.

A wholly new approach to customs treatment for postal items is needed, one that draws more creatively and objectively from the three types of existing customs controls: controls for mail, freight, and baggage. For the clearance of letters, documents, printed papers, and very low value items, the relatively simple approach applied to mail should probably be uniformly applied. For clearance of relatively low value, dutiable postal parcels, customs procedures developed for baggage clearance could form the starting point. Customs duties could be stated as an average rate, eliminating the need for customs classification. Except for special categories of goods, entry can probably be eliminated entirely in favor of minimal record keeping obligations on the part of international postal operators and periodic sampling. Collection of duty would thus initially depend upon the honesty of the shipper, who declares the value, and the postal operator, who calculates the duty, an approach equivalent to the red door / green door system for baggage. Periodic checks of postal operators and large shippers can be made using the records of the postal operator. Customs treatment for higher value “non-postal” items carried by a postal operator would be modeled on customs procedures now applied to express services.

3.8 PROHIBITION AGAINST STATE AIDS

It is obvious that international postal services among signatory countries will be distorted if any signatory country provides state aid to a postal operator, such as access to revenues of a postal monopoly, low-interest loans, or special treatment under tax, customs, or other laws. While state aids are a normal problem in international trade, the large historic involvement in postal services and the relatively small scale of international operations compared to domestic operations may require special considerations, such as requirements of structural separation from domestic postal monopolies.¹⁵

3.9. AID PROGRAM FOR THE POSTAL SYSTEMS OF DEVELOPING COUNTRIES

Currently, the “terminal dues” arrangements under which post offices charge each other for the delivery of international mail create a financial windfall for post offices with low unit costs, especially if they have a large inward imbalance. These arrangements have been justified as a means of assisting developing countries in the development of their postal infrastructures, but they offer an inefficient means of accomplishing such objectives for several reasons. First, financial benefits are not concentrated on those who truly need them. Indeed, the post offices of the United States and the United Kingdom are probably net beneficiaries of terminal dues because they are, due to large volume, post offices with relatively low unit costs. Second, this system does not guarantee that the funds generated will in fact be directed towards improving the postal infrastructure in developing countries, a problem long recognized by the Universal Postal Union. Third, even if the financial benefits of this system go, as intended, to postal operators in developing countries, these benefits may be unwisely conferred if the recipient country has a greater need for assistance in other areas. Last, and not least, current terminal dues arrangements distort international postal services by creating artificial incentives for shifting mail among public postal operators.

Whether or not the New Postal Convention should maintain a tax on international postal systems to assist the development of domestic post offices in developing countries is a question that needs reconsideration. Insofar as such a program is favored by signatory countries, a new means of funding and administering the program should be developed. Like other governmental measures, funding of this program should be financially neutral with respect to all international postal services.

¹⁵A related issue may arise in respect to public operators of non-signatory countries. Signatory countries will not want to create an incentive for other countries to stay out of a Convention on International Postal Systems by giving their public postal operators more lenient treatment than their own public postal operators; hence, signatory countries may pledge to enforce such prohibitions against state aids against all public operators. Indeed, the fact that public operators, some arguably invigorated with state aid, are already opening offices in other countries suggests the importance of adopting international rules in this area.

3.10. STANDARDIZATION OF TRADE STATISTICS

Wise policy requires a basic knowledge of the market. A new Convention on International Postal Systems should consider the problem of how to develop useful statistics in a commercially neutral manner. Presently available statistics for international postal traffic suffer from historic deficiencies. They include only public operators even though, in some categories of postal traffic, private operators now comprise a significant fraction of the market. Statistics also fail to distinguish between the different types of postal services (traditional, express, bulk, etc.), even though these have become the most commercially important distinctions. Meanwhile, distinctions drawn in official statistics are based on content, a basis that probably needs amendment.

3.11 ROLE OF POSTAL OPERATORS

In UPU framework, coordination of international postal services requires a continuous dialogue among member countries and, necessarily, heavy involvement by the public postal operators. In contrast, under a Convention on International Postal Systems, coordination of international postal services will be commercial matter for international postal systems to address. In addition, national postal operators should be free to use the international transport system to sent postal items to each other directly as they do now, but such exchanges will follow contractual rather than treaty arrangements. Central administration of a Convention on International Postal Systems should be minimal and participation by postal operators unnecessary.

3.12 RELATIONS WITH NON-SIGNATORY COUNTRIES

While a Convention on International Postal Systems would represent a break from current international postal law, there does not seem any reason why it should be incompatible with the worldwide legal framework established by the Universal Postal Convention. The Universal Postal Convention already admits of the possibility of “restricted unions,” or regional groups of countries who provide for alternatives to UPU provisions in postal exchanges among themselves. In addition, any group of postal administrations may adopt a terminal dues arrangement among themselves in preference to UPU standards. In each case, relations between those in the group and those outside the group are still governed by the UPU rules. While modification of the Universal Postal Convention may be required to admit the possibility of an Convention on International Postal Systems, there seems no reason why it should not continue to govern relations between signatory countries and other countries.¹⁶

¹⁶To avoid treating non-signatory countries in a manner less favorable than signatory countries, it may be necessary to provide that a Convention on International Postal Systems can be joined by any non-signatory country at will.

4. CONCLUSIONS

A brief review of the history of the postal sector is useful to clarify how changing technology has changed the economic and social function of postal services. The last quarter of the 20th century has seen the introduction of long distance technologies which, as in the last quarter of the 19th century, have greatly stimulated the postal sector and, in particular, its participation in long distance markets. Unlike in the last century, these modern technologies are fully transferable to the international market, but so far their effect on international markets has been muted. Regulatory simplifications which have been adopted at the national level to facilitate postal markets have yet to be introduced at the international level.

The success of national postal markets and the rise of international express operators seems to imply the need for a wholly new governmental approach to international postal services if the postal sector is to play the same beneficial role in the international economy that it has in domestic economies. The international legal structure needs to encourage, rather than restrain, the development of a variety of end-to-end international postal systems. To begin this process, a new Convention on International Postal Systems could to be developed among like-minded nations. As in the last quarter of the 19th century, it may be that their example will soon be followed by all nations.

4

Comment on REIMS II Terminal Dues Agreement (1998)*

On 20 February 1998, the European Commission, in accordance with paragraph 19(3) of Council Regulation No. 17,¹ published a summary of the notification of an agreement among the thirteen public postal operators of Austria, Denmark, Finland, France, Germany, Greece, Iceland, Italy, Luxembourg, Norway, Portugal, Spain, and the United Kingdom (the "Parties") and invited observations from interested third parties.² The notified agreement is "Agreement for the Remuneration of Mandatory Deliveries of Cross-Border Mails (REIMS II)". REIMS II fixes charges ("terminal dues") that participants apply to each other for the delivery of cross-border letters and documents. The Parties have requested a ruling from the Commission that REIMS II qualifies for an exception from the competition rules under the stringent public interest requirements of Article 85(3) of the EC Treaty.

For the reasons set out in this comment, the European Express Organisation (EEO) urges the Commission not to grant the requested ruling, except in the limited manner described below. EEO's position, however, is necessarily based on incomplete information. If the Commission publishes the relevant data, as urged in this comment, EEO will be glad to revisit its position and offer a more considered analysis.

*Submitted to European Commission as European Express Organisation, "Comments on Renewed Notification of an Agreement on Terminal Dues (REIMS II) between Postal Operators, Case No IV/36.748 -- REIMS II" (Mar. 12, 1998).

¹OJ 13, 21.2.1962, p. 204/62. REIMS I was notified in December 1995, and the EEO submitted comments to the Commission in case No IV/35.849 on 18 March 1996.

²Renewed Notification of An Agreement on Terminal Dues (REIMS II) between Postal Operators, Case No. IV/36.748 -- REIMS II, OJ C53/03, 20.2.1998.

1. EEO URGES THE COMMISSION TO PUBLISH THE FULL TEXT OF THE REIMS II AGREEMENT AND SUCH ADDITIONAL DATA AS MAY BE NECESSARY FOR INFORMED PUBLIC COMMENT.

EEO urges the Commission to publish the full text of the REIMS II agreement—except for information which the Commission determines to be true business secrets—and sufficient supporting data to allow the public to a reasonable opportunity to assess the object and effects of REIMS II and the presence or absence of pro-competitive benefits. Unless fully apprised of the details of the agreement and its impact, the public will not be able to offer informed and helpful observations to the Commission. In addition to the text of the agreement itself, supporting data such as the following are needed:

- the volume of postal traffic between pairs of Member States for each postal item defined in the "standard structure": priority and non-priority letters, flats, packets;
- a schedule of postal tariffs for derivation of the "linear tariff" and an example showing clearly how the linear tariff can be derived from postal tariffs;
- copies, or detailed summaries, of arguments that the Parties have submitted to demonstrate the public interest benefits of REIMS II.³

The case for full transparency in Commission procedures is especially compelling in the case of the REIMS II agreement in light of several considerations:

- This is one of the most important Article 85(3) agreements to be examined by the Commission. It affects not only the large volume of mail exchanged between Member States, but also the much larger universe of commercial transactions affected by such mail.
- The subject matter of the REIMS II agreement is *public* in nature. Services regulated by the REIMS II agreement are, for the most part, services that benefit directly from special or exclusive rights granted to national public postal operators. Even non-reserved services encompassed by REIMS II are services provided by public undertakings in a dominant position.
- The Parties supporting REIMS II have a well known history of engaging in anti-competitive agreements proven unacceptable under Article 85(3): the CEPT scheme of 1987, the UPU scheme of 1989, the UPU scheme of 1994, and the REIMS I scheme of 1995.
- The Parties have used past terminal dues agreements to justify still further types of anti-competitive behavior, including interception of incoming cross-border mail and prosecution of carriers of outgoing remail.

REIMS II represents the first test of the Commission's resolve to apply the

³The burden of proof for demonstrating compliance with the conditions of Article 85(3) lies with undertakings participating in the agreement in question; it is impossible for the public to comment on whether the parties have met this standard without an understanding of the evidence put forward.

competition rules to public postal operators since publication of the Postal Notice.⁴ For the Commission to fail to enforce the competition rules vigorously at this stage would undercut fatally the good intentions expressions in the Notice.

2. ASSESSMENT OF CURRENT DISTORTIONS IN THE EXCHANGE OF INTRA-COMMUNITY POSTAL SERVICES

REIMS II proposes a four-year transition from a current situation in which trade in postal services between Member States is admittedly distorted by a terminal dues agreement to a new situation in which trade in postal services is undistorted, or at least substantially less distorted. EEO submits that the first step in evaluating REIMS II is *to assess the distortions in the current situation*. Is there a social benefit to prolonging current distortions in some measure for an additional four years? If not, the proper solution is clearly to end them without lengthy transition.

What would an undistorted, market-based exchange of postal services look like? If there were no multilateral terminal dues agreement, each origin post office would negotiate separately with each destination post office for the delivery of cross-border mail. Each origin post office would be willing to pay a delivery fee roughly equivalent to the fee that the destination post office charges large domestic mailers. Like any other big mailer, an origin post office would qualify for discounts if mail is tendered in a well-sorted condition. It also seems reasonable to suppose that an origin post office would be willing to pay more for better quality of service or, alternatively, would demand rebates in case of substandard service. If an origin post office found the price for mail delivery too high for the delivery service offered, it might arrange for private delivery in the destination country. In short, in an undistorted market, each post office would distribute its intra-Community mail to other post offices in the same manner as other large Community undertakings.

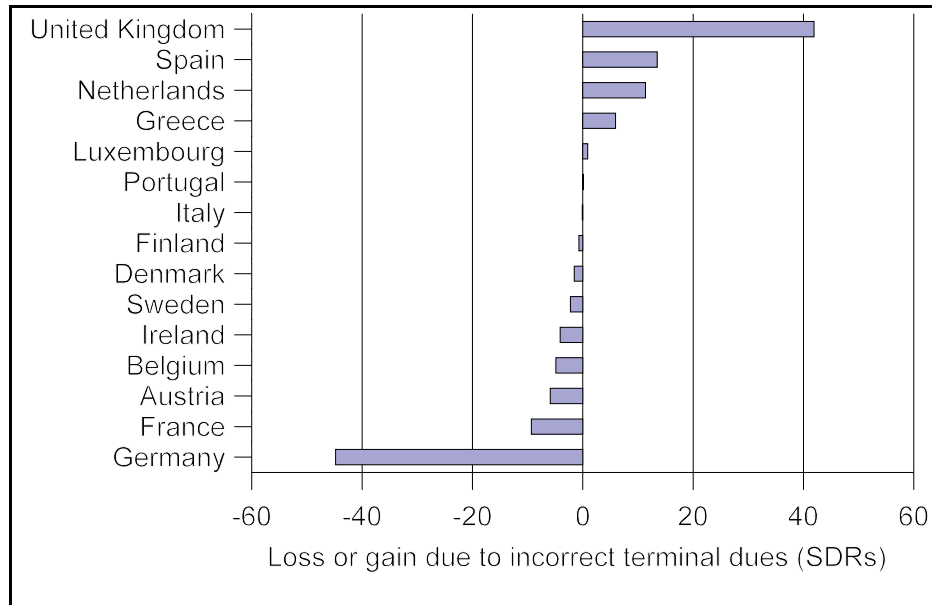
Although the national postal monopoly laws make it impossible to ascertain exactly how far the current situation departs from a market solution, study of the REIMS II agreement sheds some light. After a transition period, the REIMS II agreement proposes that post offices pay each other, roughly, 80 percent of the domestic postage rate for the delivery of priority mail and 72 percent of the domestic postage rate for non-priority mail.⁵ In putting forward these figures, the Parties are implicitly claiming that, in a competitive market, cross-border mailers and destination post offices would settle upon the prices and service guarantees reflected in REIMS II; otherwise, they are proposing a permanent distortion in the trade in cross-border mail services between Member States, and REIMS II should be rejected on that ground alone.

If one assumes that 80 percent of domestic postage is approximately the

⁴Notice from the Commission on the application of the competition rules to the postal sector and on the assessment of certain State measures relating to postal services. OJ C 39/02, 6.2.1998.

⁵The minimum price rules in Article 3.6, the "standard structure" in Annex 2, and the "cap system" in Annex 4 represent deviations, perhaps of substantial magnitude, from the percentages of domestic postage found in Article 2.

Figure 7. Distortions in current LC terminal dues payments (EEO model)



correct, undistorted price for the delivery of cross-border mail, it is possible to estimate the current level of distortions in cross-border postal services from current traffic and postage rate data. While EEO does not have such data, EEO has derived a plausible matrix of bilateral postal traffic flows from publicly available data for 1994.⁶ This matrix includes only letters and cards, not printed matter. The EEO model is not a substitute for obtaining actual mail flow data from Member State post offices. EEO's calculations offer only a rough guide to points requiring further investigation. Nonetheless, EEO believes that its model reveals the basic distortions inherent in the current situation and illustrates the type of economic analysis which, as a matter of EC law, is necessary to properly evaluate the applicability of Article 85(3) to an agreement such as REIMS II.

Using the EEO model, it may be seen that, in terms of net payments, some EU post offices are paying too much for delivery of cross-border mail and some post offices are paying too little. The situation is summarized in Figure 1. As Figure 1 indicates, according to the EEO model, *the overall effect of the present CEPT LC terminal dues scheme is to create a cross- subsidy of 74 million SDRs*⁷. This cross-subsidy is paid from certain post offices (Losers) to other post offices (Gainers). The main Gainer is the U.K. Post Office, which collects about 57 percent of the entire EU terminal dues cross-subsidy. The post offices of Spain, the Netherlands, and Greece are also significant Gainers. The main Loser is the Deutsche Post AG, with about 61 percent of the entire cross-subsidy. To a lesser extent, the post offices of France,

⁶See Appendix 1. Cross-border postal volume has probably grown marginally since 1994 but not so much as to undercut the correctness of EEO's analysis. This analysis is similar to, but more refined than, the analysis EEO presented in its comment on the first REIMS agreement.

⁷A Special Drawing Right is monetary unit denominated by reference to a basket of major national currencies defined by the International Monetary Fund.

Austria, Belgium, and Ireland are also Losers. These results need to be interpreted carefully because the foregoing calculations include several simplifications, including the absence of printed matter mail. Nonetheless, Figure 1 probably represents a broadly correct picture of distortions created by the present CEPT terminal dues scheme.

Table 1 shows some details of this cross-subsidy scheme. In sum, all post offices benefit similarly from a reduction in outward mail costs; in the EEO model, all post offices pay about 62% of the "correct" terminal dues rates for delivery of outward mail (i.e., 62% of 80% of domestic postage). Some post offices, however, deliver inward mail at far less than the correct terminal dues level while others, due to their low cost structures, are more fairly compensated. In the EEO model, the U.K. Post Office, for example, collects about 82 percent of the correct delivery charge whereas the Deutsche Post AG collects only about 46 percent. The result is that the U.K. Post Office loses a small sum on delivery of cross-border mail (16 million SDR) but gains a large amount (60 million SDR) from underpaying other post offices for delivery of its outward mail. On the other hand, the Deutsche Post AG gains only a small amount from underpaying other post offices for delivery of its outward mail (20 million SDR) and suffers a large loss (65 million SDR) because it is underpaid for its delivery of inward mail sent by other post offices.

Table 1. Details of distortions due to CEPT terminal dues scheme (EEO model)

	Net gain (loss) due to CEPT mil SDR	Under (over) payment outward mail mil SDR	Over (under) payment inward mail mil SDR	CEPT payment as percent of 80% payment	
				Outward TD costs	Inward TD revenues
U n i t e d Kingdom	41.9	57.7	-15.8	57%	82%
Spain	13.5	10.7	2.8	61%	133%
Netherlands	11.4	30.3	-18.9	62%	64%
Greece	5.9	5.0	0.9	62%	126%
Luxembourg	0.9	2.0	-1.2	62%	67%
Portugal	0.1	0.1	0.0	62%	113%
Italy	-0.1	10.3	-10.4	62%	65%
Finland	-0.7	1.6	-2.3	62%	59%
Denmark	-1.5	8.0	-9.5	63%	47%
Sweden	-2.2	4.7	-7.0	62%	66%
Ireland	-4.1	3.9	-8.0	62%	62%
Belgium	-4.9	8.3	-13.2	63%	59%
Austria	-5.9	12.3	-18.2	63%	54%
France	-9.4	20.6	-29.9	63%	56%
Germany	-44.8	19.7	-64.5	67%	46%
Totals	0.0	195.3	-195.3	62%	62%

How do Gainers extract this cross subsidy from Losers? There appear to be at least two factors at work:

- *The primary factor appears to be abuse of dominant position.* In terminal dues negotiations, Gainers use their domestic postal monopolies to force Losers to deliver cross-border mail at rates which are less than indicated by domestic postage. Without a monopoly over the delivery inward cross-border mail, Gainers would have far less bargaining power in terminal dues negotiations.
- A secondary cause may be a shared interest among Gainers and Losers to exclude competition. A Loser might be more willing to turn to an alternative delivery agent for its mail in a Gainer country if it did not fear that this precedent would lead other post offices to arrange for alternative delivery of cross-border mail in the Loser's own country.

3. THE REIMS II AGREEMENT

In brief, the REIMS II agreement proposes to phase out current distortions by moving towards a system of terminal dues payments more closely aligned with domestic postage. There are two primary mechanisms to accomplish this objective:

- terminal dues for cross-border mail over three year period will rise to 55% of domestic postage in 1998, 65% in 1999, 70% in 2000, and 80% in 2001, subject to a minimum terminal dues rule (Article 3.6).
- origin post offices are authorized to access bulk domestic postage rates for the delivery of cross-border mail.

Since the primary source of distortion effected by the CEPT agreement is the maintenance of artificially low charges for inward delivery in the Loser countries,⁸ it is the first mechanism that is the most important. There are many additional qualifications and controls in REIMS II, including "caps" on the volumes of mail accorded special rates if originating in Greece, Italy, or Spain, but these appear to have secondary economic effects.

Stripped to its essentials, REIMS II appears to be a proposal by three of the four Gainers, to phase out their practice of using monopoly power to demand non-compensatory delivery rates from Loser post offices over a period of four years. The main Gainer, the U.K. Post Office, proposes to reduce its exercise of monopoly over a period of 3 years. The Spanish Post Office proposes an 8-year phase out period for its subsidy. The Greek Post Office proposes a 6-year period. The fourth Gainer, the Dutch Post Office, is not a party to the REIMS II agreement.

4. REIMS II CANNOT QUALIFY FOR EXEMPTION FROM THE COMPETITION RULES UNDER ARTICLE 85(3).

There can be no doubt that REIMS II is inconsistent with Article 85(1); that

⁸According to Table 1, under the CEPT scheme, only the post offices of Spain and Greece are paid more than 80 percent of domestic postage for inward delivery.

is, REIMS II is clearly an agreement between undertakings which affects trade between Member States and has as its object or effect the restriction or distortion of competition within the common market.

Under paragraph 3 of Article 85, the Commission may declare the inapplicability of Article 85(1) of the EC Treaty if four *cumulative* legal tests are satisfied:

- a) Does REIMS II improve or promote (i) the production or the distribution of goods or (ii) promote technical or economic progress?
- b) Does REIMS II allow "consumers a fair share of the resulting benefit"?
- c) Does REIMS II avoid imposing on the undertakings concerned "restrictions which are not indispensable to the attainment of these objectives"?
- d) Does REIMS II avoid affording the undertakings concerned "the possibility of eliminating competition in respect to a substantial part of the products in question"?

EEO submits that REIMS II cannot pass muster under these four legal standards.

REIMS II plainly does not meet condition (a). Almost three quarters of the cross-subsidy created by the CEPT scheme goes to two of the most efficient and least needy of EU post offices, the U.K. Post Office and Dutch Post Office. This cross-subsidy is paid primarily by two of the least efficient post offices: those offices of Germany and France. *A cross-subsidy from the least efficient to the most efficient producers certainly does not promote the production or distribution of goods or any other measure of economic progress.* Why should such a scheme be continued for another four years even at reduced levels? Moreover, *for the Community as a whole, REIMS II will have no effect at all on the production of postal services* since it will have no effect on actual costs. With or without REIMS II, the same employees will be paid the same salaries to deliver the same cross-border mail. Nor is there any reason to believe that REIMS II will affect the total sum of postage that Community mailers pay for the distribution of cross-border mail. REIMS II is an accounting agreement among post offices that, through abuse of monopoly power, creates a subsidy for the benefit of a handful of Community post offices.

Likewise REIMS II does not meet condition (b). Nothing in the REIMS II agreement requires the main beneficiaries of the scheme—the post offices of the United Kingdom and the Netherlands—to pass on to consumers the value of cross-subsidies in the form of lower postage rates.

REIMS II fails to fulfill condition (c) because it obviously imposes restrictions during the transition period which are "not indispensable to the attainment of its objectives." Insofar as a public purpose can be fairly discerned in the transition period required by REIMS II, it appears to be to provide a suitable adjustment period for post offices which lose net revenue in the shift from a distorted situation to an undistorted situation and which are not financially strong enough to withstand a

more abrupt change.⁹ If this is the public objective to be achieved by the transition period of REIMS II, the post offices of the United Kingdom and the Netherlands can be omitted. Both are large, efficient, financially sound undertakings which can withstand the change to an undistorted terminal dues system in the shortest possible period.¹⁰

If the U.K. Post Office is deleted from the REIMS II transition period (and assuming the Dutch Post Office remains out of it), what remains is, in essence, a temporary subsidy program for the benefit of two post offices: the Spanish Post Office and Greek Post Office. Can an agreement among post offices to provide temporary economic assistance to these two post offices be justified under Article 85(3)? Possibly. But not in the format presented by REIMS II. There is no reason to control all cross-border mail in order to raise the relatively small sums to be provided these two post offices. Nor is there any justification in loading the lion's share of cost of such a cross-subsidy on German mailers.

It would be far simpler for Community post offices to agree to make contributions to a development fund based on their gross revenues. A development fund paid directly to the post offices of Spain and Greece represents a much more flexible mechanism for protecting those truly in need of relief as terminal dues are aligned to domestic postage rates. For example, a development fund could be used to underwrite the costs of low cost "cross-border stamps" which would be sold only in small quantities and only in Spanish and Greek post offices. Use of low cost "cross-border stamps" could be restricted to cross-border letters posted individually; i.e., they would not be useable for either postcards or bulk mailings. Such a program would guarantee that all small mailers of correspondence in Spain and Greece would continue to have access to low priced cross-border postal services. In contrast, the Cap System proposed in REIMS II is fraught with problems. Under the Cap System, low terminal dues rates are applied to all mail up to certain amounts. How are Cap post offices supposed to prevent the volume of mail from exceeding the Caps? Will they keep cross-border postage rates high, defeating the purpose of the subsidy? Will they keep cross-border rates low and arbitrarily regulate which customers have access to low cross-border postage rates? The relationship between the Cap System and truly needy customers, if any, is entirely unclear.

Finally, REIMS II fails to meet condition (d) because it affords undertakings the possibility of eliminating competition.¹¹ It is well known that post offices have

⁹Paragraph 6 of the Commission's notice states that the aims of the agreement are to provide the Parties with fair compensation for delivery of cross-border mail and to improve the quality of cross-border mail service. Neither aim, however, implies the need for a transition period.

¹⁰In 1994, a loss of 42 million SDR in cross-subsidy income for the U.K. Post Office would have amounted to about two-thirds of 1 percent of total revenues. The post office of the Luxembourg is also a small Gainer under the current distorted system and likewise seems capable of handling an undistorted terminal dues system without undue financial strain.

¹¹It has been found that condition (d) is not met if the agreement in question affects all suppliers (Case 209/78, Van Landewyck v. Commission, [1980] ECR 3125), affects all purchasers

cited distortions caused by terminal dues agreements to justify invocation of the flagrantly anti-competitive UPU Article 25 (paragraphs 1 to 4). REIMS continues these distortions for four years. Moreover, REIMS II obliquely refers to the possibility of continued enforcement of UPU Article 25 by declaring only that UPU Article 25 *paragraph 4* will not be applied after the transition period.

EEO is aware that some postal officials have offered indirect support for the transition period by arguing that they (and their customers) should not be forced to pay the high costs of inefficient post offices like the Deutsche Post AG when they have no ability to correct such inefficiencies. As a general proposition, EEO agrees with this argument but draws a different conclusion. Citizens of the European Union should not be forced to bear the costs of inefficiencies created by postal monopolies in *other* Member States because they have no means—other than by resort to the EC law—of correcting these inefficiencies. All EU citizens should be able to make their own arrangements for alternative end-to-end delivery of cross-border mail. In other words, cross-border postal services should be liberalized outward and inward to protect the rights of all Community mailers. The only limits to this principle should be those necessary to protect universal postal service in the destination country. This principle, however, in no way lends support for the practice of inefficient post offices offering especially low postage rates to efficient post offices such as the U.K. Post Office. Why should the U.K. Post Office¹² be given special favors? If "inefficient" post offices should be forced to give "efficient" postage rates to other EU citizens, then this privilege should be extended to carriers of postal items, public and private, and "efficient" post offices should get on with collecting the correct charges for inward delivery of cross-border mail.

5. ANY COMMISSION APPROVAL OF REIMS II SHOULD BE STRICTLY LIMITED AND CONDITIONED.

For the foregoing reasons, EEO submits that the only possible basis for approval of REIMS II is as a temporary expedient, for one year only, so as to give participants time to implement the following principles:

- Within one year, all EU post offices should adopt and publish rates for the delivery of inward cross-border mail encompassed by the universal service obligation announced in the Postal Services Directive; these rates should be aligned to domestic postage rates and may be expressed in a linear form for ease of application by cross-border mailers.

(Case 61/80, *Coöperatieve Stremsel-en Kleurselfabriek v. Commission*, [1981] ECR 851), reinforces an existing monopoly (Commission Decision WANO Schwarzpulver, OJEC (1978) L322/26), or the proponents failed to demonstrate the likelihood of continued, lively competition (Commission Decision VW/MAN, OJEC (1983) L 376/11).

¹²As table 1 shows, leaving aside the post offices of Spain and Greece (discussed below) and the Dutch Post Office (which is not a party to REIMS II), other Community post offices do not gain from low terminal dues rates provided by inefficient post offices because they "pay" for these benefits by delivering return mail at low terminal dues rates.

- All retail and bulk rates for postal delivery of *cross-border* mail in the reserved area should be made fully transparent and available to all operators, public and private, and other mailers on a non-discriminatory basis.
- All retail and bulk rates for postal delivery of *domestic* mail in the reserved area should be made fully transparent and available to all operators, public and private, and other mailers on a non-discriminatory basis.
- Post offices may agree to make contributions to a development fund for the benefit of the post offices of Spain and Greece provided such contributions are apportioned among Community mailers in a transparent and non-discriminatory manner and the funds are reserved for the use of legitimate social purposes.
- Post offices may also make other purely technical arrangements as may be necessary to facilitate the exchange of mail.

These principles are largely self-executing. So long as post offices have access to domestic rates (including domestic bulk rates), they will be inhibited from proposing linear tariffs for delivery of inward cross-border mail that are *higher* than domestic postage. So long as they have no access to preferential rates from other post offices, post offices will have no incentive to develop linear tariffs for delivery of inward cross-border mail that are *lower* than domestic postage. There will be no need for complex negotiations among Community post offices to harmonize precisely the relationship between inward cross-border rates and domestic postage rates.

Moreover, as the Commission is well aware, the distortions caused by misalignment between terminal dues and domestic postage rates, have been used to justify other anti-competitive activities. EEO submits, that, at a minimum, renunciation of such anti-competitive activities should be a necessary condition of Commission approval of any terminal dues agreement. This principle implies the following conditions:

- A Party to a terminal dues agreement approved by the Commission should be prohibited from applying Article 25 UPU, paragraphs 1 to 4, to any *inward* mail received from any other Party in the terminal dues agreement. So long as a post office is properly compensated for delivery of inward mail, there is no justification for interception of ABA remail.
- A Party to a terminal dues agreement approved by the Commission should be prohibited from restricting *outward* remail services if other Parties to the agreement account for one-half or more of the Party's inward cross-border mail. Outward mail services achieve few economies of scale and contribute little or nothing to the maintenance of universal postal service. So long as a post office is properly compensated for delivery of inward mail, there is no justification for restriction of outward remail.
- A Party to a terminal dues agreement approved by the Commission should be required to qualify participation in the 1999 Universal Postal Convention so that other UPU member countries are not authorized to

engage in anti-competitive activities which benefit the Party. For example, if a Community post office participates in a terminal dues agreement approved by the Commission, it should not in 1999 agree to a new version of Article 25 that authorizes a post office of a non-Community country to intercept remail originating from a Community country. A Party to a terminal dues agreement should be not be able to use a foreign public postal operator to restrict competition indirectly when it cannot implement such restrictions directly.

6. PARTIES SHOULD BE STRONGLY ENCOURAGED TO SUPPORT GENERAL REFORM OF THE TERMINAL DUES AND REMAIL PROVISIONS OF THE 1999 UNIVERSAL POSTAL CONVENTION.

These recommended conditions do not address the most difficult problem posed by remail and incorrect terminal dues arrangements: remailing of postal items originating in a Member State, through a non-Community post office, and back to a Community addressee. While this problem is difficult, it is also largely one of the post offices' own making. They have not, heretofore, vigorously and uniformly pressed for rationalization of terminal dues at the UPU. Indeed, the REIMS II agreement itself reflects a perpetuation of key vices of the UPU terminal dues scheme: (i) payments misaligned with domestic postage and (ii) developmental assistance in the form of economically incorrect fees instead of direct (and carefully directed) aid for truly social purposes.

If the Commission will forthrightly prohibit resort to such misguided policies within the Community, it will also make clear to Member State public postal operators that they should now work collectively and assiduously for reform at UPU level in the 1999 Congress if they expect relief from "extra-Community ABA remail" after the 1999 Convention. At the same time, the Commission will be well positioned to make clear to the United States that its obstructionist approach towards UPU reform must also come to an end. With the support of Community post offices and the United States, global reform in the 1999 UPU Congress may indeed be possible.

Appendix 1

REIMS II - EEO Model for Estimating Economic Effects on Letter Mail

Tables

- Table 1. Estimated intra-Community postal volumes (1994)
- Table 2. Terminal dues per typical LC item (1994)
- Table 3. Basis for estimating distribution of cross-border mail
- Table 4a. Distribution of intra-EU mail (1994) - first approximation
- Table 4b. Distribution of intra-EU mail (1994) - second approximation
- Table 4c. Distribution of intra-EU mail (1994) - third approximation
- Table 5a. Estimated cost of outward mail at CEPT TDs (1994)
- Table 5b. Estimated cost of outward mail at 55% domestic postage (1994)
- Table 5c. Estimated cost of outward mail at 65% domestic postage (1994)
- Table 5d. Estimated cost of outward mail at 70% domestic postage (1994)
- Table 5e. Estimated cost of outward mail at 80% domestic postage (1994)
- Table 6. Summary of net profit or loss on TDs at various TD levels
- Table 7. Net gain or loss from incorrect TDs compared to 80% TDs
- Table 8. Relative impact of shifting from CEPT to 80% domestic postage
- Table 9. Sources of distortion due to CEPT terminal dues

General Notes

- 1 Universal Postal Union data for 1994 has been relied upon for the total inbound and outbound mail volumes for the post offices of most Member States. Missing data has been estimated by extrapolating from the latest available figures using general growth rates experienced in the Community.
- 2 It has been assumed that for each Community post office, two thirds of outbound mail is destined for other Community post offices. Inbound intra-EU mail volume is set equal to outbound intra-EU mail volume.
- 3 As a first approximation, it was assumed that, for each Community post office, the outbound intra-Community mail is distributed to other Community post offices based upon the relative amount of inbound mail received by that post office. For example, assume that the French post office receives twice as much mail as the Spanish post office; then one may estimate that twice as much of the outbound mail of the U.K. post office goes to the French post office than to the Spanish post office. After distributing each post office's outbound mail volume in this fashion, inconsistencies appear between the inbound mail volumes recorded by the UPU and the sum of the individual inbound mail flows assumed for each Member State. Two further approximations were introduced to lessen these inconsistencies. The result is matrix of bilateral mail flows and that is, to reasonable degree, internally consistent and consistent with total outbound and inbound mail volumes.
- 4 It has been assumed that all letters and cards qualify for the first postage rate category and weigh 14.8 grams each.

Table 1. Estimated intra-Community postal volumes (1994)

		1a	1b	1c	1d	1e	1f	1g	1h
		Domestic Volume mil	Outward Volume mil	Inward Volume mil	Outward as % Domestic	Outward Intra EU mil	Inward Intra EU mil	Positive Imbalance mil	Negative Imbalance mil
Austria	A	1,418	183	182	13%	120	124	-	-3
Belgium	B	1,114	121	162	11%	80	110	-	-30
Denmark	DK	927	117	73	13%	77	50	28	-
Finland	FIN	755	24	29	3%	16	20	-	-4
France	F	6,247	308	330	5%	204	224	-	-21
Germany	D	9,263	356	469	4%	235	319	-	-84
Greece	GR	105	71	40	67%	47	27	20	-
Ireland	IRL	439	57	113	13%	37	77	-	-40
Italy	I	6,617	147	166	2%	97	113	-	-16
Luxembourg	L	103	29	21	29%	19	14	5	-
Netherlands	NL	6,299	435	290	7%	287	197	89	-
Portugal	P	23	1	1	4%	1	0	0	-
Spain	E	2,768	147	96	5%	97	65	32	-
Sweden	SWE	1,430	68	115	5%	45	78	-	-34
United Kingdom	UK	8,543	718	613	8%	474	417	57	-
Totals		46,052	2,780	2,699	6%	1,835	1,835	231	-231

- Notes
- 1 66 percent of outward EU LC mail volume assumed destined for other EU countries; 67.97 percent of inward mail assumed from other EU post offices (so that total inward intra-EU mail volume equals to outward intra-EU mail volume).
 - 2 Italy data from 1993.
 - 3 Netherlands data based on 1989 data with domestic volume increased by 14% and outward and inward increased by 25% (growth levels of UK post office).
 - 4 Portugese inward volume based upon 1994 outward volume and 1991 in/out ratio.
 - 5 UK domestic and outward volume assumes 51% and 85% of letter post is LC, same as Germany.
 - 6 UK inward volume based upon 1994 outward volume and 1991 in/out ratio.
 - 7 Percent of inward mail assumed originating in EU adjusted so inward intra EU mail = outward intra EU mail.

Source Universal Postal Union, Statistics (annual).

Table 2. Terminal dues per typical LC item (1994)

		3a	3b	3c	3d	3e	3f	3g	3h	3i	3k	3l
		CEPT	Domestic	Domestic	55%	65%	70%	80%	Minimum TD rule (Article 3.6)			
		TDs	Postage	Postage	Dom. Post.	Dom. Post.	Dom. Post.	Dom. Post.	55%	65%	70%	80%
		SDR	Local cur	SDR	SDR	SDR	SDR	SDR	Dom. Post.	Dom. Post.	Dom. Post.	Dom. Post.
									SDR	SDR	SDR	SDR
Austria	A	0.171	6.00	0.398	0.219	0.259	0.279	0.318	-	-	-	-
Belgium	B	0.171	16.00	0.363	0.200	0.236	0.254	0.291	-	-	-	-
Denmark	DK	0.171	3.75	0.453	0.249	0.294	0.317	0.362	-	-	-	-
Finland	FIN	0.171	2.40	0.362	0.199	0.235	0.253	0.289	-	-	-	-
France	F	0.171	2.80	0.381	0.209	0.247	0.266	0.304	-	-	-	-
Germany	D	0.171	1.00	0.466	0.257	0.303	0.326	0.373	-	-	-	-
Greece	GR	0.171	60.00	0.170	0.094	0.111	0.119	0.136	0.136	0.136	0.136	0.136
Ireland	IRL	0.171	0.32	0.344	0.189	0.224	0.241	0.276	-	-	-	-
Italy	I	0.171	0.75	0.329	0.181	0.214	0.230	0.263	-	-	-	-
Luxembourg	L	0.171	14.00	0.317	0.175	0.206	0.222	0.254	-	-	-	-
Netherlands	NL	0.171	0.80	0.333	0.183	0.217	0.233	0.267	-	-	-	-
Portugal	P	0.171	42.00	0.188	0.104	0.122	0.132	0.151	0.151	0.151	0.151	0.151
Spain	E	0.171	29.00	0.161	0.088	0.105	0.113	0.129	0.129	0.129	0.129	0.129
Sweden	SWE	0.171	3.20	0.325	0.179	0.211	0.227	0.260	-	-	-	-
United Kingdom	UK	0.171	0.25	0.261	0.144	0.170	0.183	0.209	0.169	-	-	-

- Notes
- 1 Average weight per LC in the basic weight step is assumed to be 14.63 grams (REIMS II, Annex 2- Appendix 2). CEPT TD per LC piece = 0.1491 SDR/item + (1.47 SDR per kg x 0.01463 kg per LC) = 0.171 SDR.
 - 2 Col 3b: postage rates in local currency are those in effect in July 1994. Source: TNT.
 - 3 Exchange Date = 27 Feb 1996

Table 3. Basis for estimating distribution of cross-border mail

Destination >		3a	3b	3c	3d
		Outward Intra EU mil	Inward Intra EU mil	Inward volume of other Post Offices mil	Outward volume as % of others' inward volume
Austria	A	120	124	1,711	7.0%
Belgium	B	80	110	1,725	4.6%
Denmark	DK	77	50	1,785	4.3%
Finland	FIN	16	20	1,815	0.9%
France	F	204	224	1,611	12.6%
Germany	D	235	319	1,516	15.5%
Greece	GR	47	27	1,808	2.6%
Ireland	IRL	37	77	1,758	2.1%
Italy	I	97	113	1,722	5.6%
Luxembourg	L	19	14	1,821	1.1%
Netherlands	NL	287	197	1,637	17.5%
Portugal	P	1	0	1,834	0.0%
Spain	E	97	65	1,769	5.5%
Sweden	SWE	45	78	1,757	2.5%
United Kingdom	UK	474	417	1,418	33.4%
		1,835	1,835		

- Notes
- 1 Outward and inward volumes (cols 3a and 3b) from cols 1e and 1f.
 - 2 Col 3c. "Inward volume of other post offices" is total inward volume of all EU post offices (1,835) minus inward volume the particular post office. E.g. Leaving aside Austrian post office, all other EU post offices import 1,711 million pieces of LC mail.
 - 3 Col 3d: "Outward volume as % of others' inward volume" is other post offices' inward volume (col 3c) divided by outward volume of particular post office (col 3a). E.g., Austria's outward volume accounts for about 7.0% of the inward volume of other EU post offices.

Table 4a. Distribution of intra-EU mail (1994) - first approximation

Origin POs		Outward	4aa	4ab	4ac	4ad	4ae	4af	4ag	4ah	4ai	4aj	4ak	4al	4am	4an	4ao	4ap
			DESTINATION POST OFFICES (and Actual Inward Totals)															Sum of Outward
			A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK	
			124	110	50	20	224	319	27	77	113	14	197	0	65	78	417	1,835
Austria	A	120		7.7	3.5	1.4	15.8	22.5	1.9	5.4	7.9	1.0	13.9	0.0	4.6	5.5	29.3	120
Belgium	B	80	5.7		2.3	0.9	10.4	14.7	1.3	3.5	5.2	0.6	9.1	0.0	3.0	3.6	19.2	80
Denmark	DK	77	5.4	4.8		0.9	9.7	13.8	1.2	3.3	4.9	0.6	8.6	0.0	2.8	3.4	18.1	77
Finland	FIN	16	1.1	0.9	0.4		1.9	2.7	0.2	0.7	1.0	0.1	1.7	0.0	0.6	0.7	3.6	16
France	F	204	15.6	13.9	6.3	2.5		40.3	3.4	9.7	14.2	1.8	24.9	0.1	8.3	9.9	52.7	204
Germany	D	235	19.2	17.0	7.7	3.1	34.7		4.2	11.9	17.4	2.2	30.6	0.1	10.1	12.1	64.5	235
Greece	GR	47	3.2	2.8	1.3	0.5	5.8	8.2		2.0	2.9	0.4	5.1	0.0	1.7	2.0	10.8	47
Ireland	IRL	37	2.6	2.3	1.1	0.4	4.8	6.8	0.6		2.4	0.3	4.2	0.0	1.4	1.7	8.8	37
Italy	I	97	7.0	6.2	2.8	1.1	12.6	18.0	1.5	4.3		0.8	11.1	0.0	3.7	4.4	23.5	97
Luxembourg	L	19	1.3	1.2	0.5	0.2	2.4	3.4	0.3	0.8	1.2		2.1	0.0	0.7	0.8	4.4	19
Netherlands	NL	287	21.7	19.3	8.7	3.5	39.3	55.9	4.7	13.5	19.7	2.5		0.1	11.4	13.7	73.0	287
Portugal	P	1	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1		0.0	0.0	0.2	1
Spain	E	97	6.8	6.0	2.7	1.1	12.3	17.5	1.5	4.2	6.2	0.8	10.9	0.0		4.3	22.9	97
Sweden	SWE	45	3.1	2.8	1.3	0.5	5.7	8.1	0.7	1.9	2.9	0.4	5.0	0.0	1.7		10.6	45
United Kingdom	UK	474	41.3	36.8	16.6	6.6	74.9	106.6	9.1	25.7	37.6	4.7	65.9	0.1	21.8	26.1		474
		<i>Sum of inward mail ></i>	134	122	55	23	230	319	31	87	124	16	193	1	72	88	342	1,835
		<i>Inconsistencies ></i>	-10.31	-11.83	-5.47	-2.86	-6.13	0.35	-3.47	-10.18	-10.97	-2.00	4.22	-0.07	-6.45	-10.03	75.20	

- Notes
- 1 As a first approximation, it is assumed that each destination post office receives mail from other post offices in the same percentage as those post offices contribution to the pool of cross-border mail. For example, Austria contributes 7.0% to the pool of EU cross border mail, excluding mail bound for Austria itself (col. 4d); it is assumed, then, 7.0% of the 110 millions of inward mail received in Belgium came from Austria, or 7.7 million items. inward mail.
 - 2 After distributing outward mail according to the first approximation and summing the mail presumed directed to the various destination post offices, it may be seen that sums of inward mail are inconsistent with the actual amount of inward mail received by various post offices, although the total inward mail necessarily remains equal to the total outward mail. This leads to the second approximation.

Table 4b. Distribution of intra-EU mail (1994) - second approximation

		4ba	4bb	4bc	4bd	4be	4bf	4bg	4bh	4bi	4bj	4bk	4bl	4bm	4bn	4bo	4bp	4bq		
		DESTINATION POST OFFICES (and inward EU volumes, col 4c)																Sum of		
Origin POs	Outward	A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK			Outward	Inconsis-
		124	110	50	20	224	319	27	77	113	14	197	0	65	78	417			1,835	tencies
Austria	A	120	0.0	7.0	3.1	1.2	15.4	22.5	1.7	4.8	7.2	0.9	14.2	0.0	4.2	4.9	35.8	123	-2.37	
Belgium	B	80	5.3	0.0	2.1	0.8	10.1	14.7	1.1	3.1	4.7	0.6	9.3	0.0	2.7	3.2	23.5	81	-1.61	
Denmark	DK	77	4.9	4.3	0.0	0.7	9.5	13.8	1.0	2.9	4.4	0.5	8.7	0.0	2.6	3.0	22.0	79	-1.26	
Finland	FIN	16	1.0	0.9	0.4	0.0	1.9	2.7	0.2	0.6	0.9	0.1	1.7	0.0	0.5	0.6	4.4	16	-0.23	
France	F	204	14.4	12.6	5.6	2.2	0.0	40.4	3.0	8.6	13.0	1.5	25.5	0.0	7.5	8.8	64.3	207	-3.81	
Germany	D	235	17.7	15.4	6.9	2.7	33.8	0.0	3.7	10.5	15.9	1.9	31.2	0.1	9.2	10.7	78.7	238	-3.69	
Greece	GR	47	2.9	2.6	1.2	0.4	5.6	8.2	0.0	1.7	2.6	0.3	5.2	0.0	1.5	1.8	13.1	47	-0.70	
Ireland	IRL	37	2.4	2.1	0.9	0.4	4.6	6.8	0.5	0.0	2.2	0.3	4.3	0.0	1.3	1.5	10.8	38	-0.70	
Italy	I	97	6.4	5.6	2.5	1.0	12.3	18.0	1.4	3.8	0.0	0.7	11.4	0.0	3.3	3.9	28.6	99	-1.93	
Luxembourg	L	19	1.2	1.1	0.5	0.2	2.3	3.4	0.3	0.7	1.1	0.0	2.1	0.0	0.6	0.7	5.4	20	-0.28	
Netherlands	NL	287	20.0	17.4	7.8	3.0	38.2	55.9	4.2	11.9	18.0	2.1	0.0	0.1	10.4	12.1	89.1	290	-3.48	
Portugal	P	1	0.0	0.0	0.0	0.0	0.1	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.2	1	-0.01	
Spain	E	97	6.3	5.5	2.5	0.9	12.0	17.6	1.3	3.7	5.6	0.7	11.1	0.0	0.0	3.8	28.0	99	-1.65	
Sweden	SWE	45	2.9	2.5	1.1	0.4	5.5	8.1	0.6	1.7	2.6	0.3	5.1	0.0	1.5	0.0	12.9	45	-0.84	
United Kingdom	UK	474	38.1	33.2	14.9	5.8	72.9	106.7	8.0	22.7	34.3	4.1	67.4	0.1	19.9	23.1	0.0	451	22.57	
Sum of inward >		124	110	50	20	224	319	27	77	113	14	197	0.4	65	78	417		1,835		
Correction factor from first approx >		0.92	0.90	0.90	0.87	0.97	1.00	0.89	0.88	0.91	0.87	1.02	0.87	0.91	0.89	1.22				

- Notes
- 1 In the second approximation, the inward mail assumed from each post office is reduced or increased by a factor representing the amount by which the total of assumed inward mail flows overestimated or underestimated the actual inward mail total. For example, the first approximation resulted mail flow assumptions for Austria totaling 134 million pieces of mail. In fact, Austria received only 124 million pieces. Hence, the flow from each post office to Austria is multiplied by 0.92 (124/134).
 - 2 The second approximation results in outward mail flows which, when summed for each post office, vary somewhat from actual outward mail flows. This lead to the third approximation.

Table 4c. Distribution of intra-EU mail (1994) - third approximation

		4ca	4cb	4cc	4cd	4ce	4cf	4cg	4ch	4ci	4cj	4ck	4cl	4cm	4cn	4co	4cp	4cq	
		DESTINATION POST OFFICES (and inward EU volumes, col 4c)																Sum of	Correction
Origin POs	Outward	A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK	Sum of	Correction	
		124	110	50	20	224	319	27	77	113	14	197	0	65	78	417	1,835	2d approx	
Austria	A	120	6.9	3.1	1.2	15.1	22.1	1.7	4.7	7.1	0.8	13.9	0.0	4.1	4.8	35.1	120	0.98	
Belgium	B	80	5.2	2.0	0.8	9.9	14.5	1.1	3.1	4.6	0.6	9.1	0.0	2.7	3.1	23.0	80	0.98	
Denmark	DK	77	4.9	4.2	0.7	9.3	13.6	1.0	2.9	4.4	0.5	8.6	0.0	2.5	3.0	21.7	77	0.98	
Finland	FIN	16	1.0	0.8	0.4	1.8	2.7	0.2	0.6	0.9	0.1	1.7	0.0	0.5	0.6	4.3	16	0.99	
France	F	204	14.2	12.3	5.5	2.1	39.6	3.0	8.4	12.7	1.5	25.0	0.0	7.4	8.6	63.1	204	0.98	
Germany	D	235	17.4	15.1	6.8	2.6	33.3	3.7	10.3	15.6	1.9	30.7	0.1	9.1	10.6	77.5	235	0.98	
Greece	GR	47	2.9	2.5	1.1	0.4	5.5	8.1	1.7	2.6	0.3	5.1	0.0	1.5	1.8	12.9	47	0.99	
Ireland	IRL	37	2.4	2.1	0.9	0.4	4.5	6.6	0.5	2.1	0.3	4.2	0.0	1.2	1.4	10.6	37	0.98	
Italy	I	97	6.3	5.5	2.5	1.0	12.1	1.3	3.7	0.7	11.1	0.0	3.3	3.8	28.1	97	0.98		
Luxembourg	L	19	1.2	1.0	0.5	0.2	2.3	3.4	0.3	0.7	1.1	2.1	0.0	0.6	0.7	5.3	19	0.99	
Netherlands	NL	287	19.8	17.2	7.7	3.0	37.8	4.2	11.7	17.8	2.1	0.1	10.3	12.0	88.0	287	0.99		
Portugal	P	1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.1	0.0	0.0	0.2	1	0.99		
Spain	E	97	6.2	5.4	2.4	0.9	11.8	1.3	3.7	5.5	0.7	10.9	0.0	3.7	27.5	97	0.98		
Sweden	SWE	45	2.8	2.5	1.1	0.4	5.4	7.9	0.6	1.7	2.6	0.3	5.0	1.5	12.7	45	0.98		
United Kingdom	UK	474	40.1	34.9	15.7	6.0	76.5	8.4	23.8	36.0	4.3	70.8	0.1	20.9	24.3	474	1.05		
<i>Sum of inward ></i>		124	110	50	20	225	321	27	77	113	14	198	0.4	66	78	410	1,835		
<i>Inconsistencies ></i>		-0.54	-0.43	-0.18	-0.06	-1.24	-1.85	-0.09	-0.26	-0.46	-0.04	-1.11	-0.00	-0.26	-0.27	6.78			

- Notes
- 1 In the third approximation, the outward mail flows are adjusted in the same manner that the inward mail flows were adjusted in the second approximation.
 - 2 The result of the third approximation still results in a pattern of bilateral mail flows that is not completely internally consistent. Sums of inward mail do not perfectly match outward mail flows. These inconsistencies are relatively small and should not affect the value of the model; in any case, the assumptions in the model should be replaced by actual data for bilateal mail flows.

Table 5a. Estimated cost of outward mail at CEPT TDs (1994)

		5aa	5ab	5ac	5ad	5ae	5af	5ag	5ah	5ai	5aj	5ak	5al	5am	5an	5ao	5ap	
Destination > 55% dom. postage>		A 0.171 SDR mil	B 0.171 SDR mil	DK 0.171 SDR mil	FIN 0.171 SDR mil	F 0.171 SDR mil	D 0.171 SDR mil	GR 0.171 SDR mil	IRL 0.171 SDR mil	I 0.171 SDR mil	L 0.171 SDR mil	NL 0.171 SDR mil	P 0.171 SDR mil	E 0.171 SDR mil	SWE 0.171 SDR mil	UK 0.171 SDR mil		Paid for outward SDR mil
Austria	A		1.2	0.5	0.2	2.6	3.8	0.3	0.8	1.2	0.1	2.4	0.0	0.7	0.8	6.1		21.0
Belgium	B	0.9		0.4	0.1	1.7	2.5	0.2	0.5	0.8	0.1	1.6	0.0	0.5	0.5	4.0		13.9
Denmark	DK	0.8	0.7		0.1	1.6	2.4	0.2	0.5	0.8	0.1	1.5	0.0	0.4	0.5	3.8		13.4
Finland	FIN	0.2	0.1	0.1		0.3	0.5	0.0	0.1	0.2	0.0	0.3	0.0	0.1	0.1	0.7		2.7
France	F	2.5	2.1	1.0	0.4		6.9	0.5	1.5	2.2	0.3	4.4	0.0	1.3	1.5	11.0		35.4
Germany	D	3.0	2.6	1.2	0.5	5.8		0.6	1.8	2.7	0.3	5.3	0.0	1.6	1.8	13.5		40.7
Greece	GR	0.5	0.4	0.2	0.1	1.0	1.4		0.3	0.5	0.1	0.9	0.0	0.3	0.3	2.2		8.1
Ireland	IRL	0.4	0.4	0.2	0.1	0.8	1.2	0.1		0.4	0.0	0.7	0.0	0.2	0.3	1.8		6.5
Italy	I	1.1	1.0	0.4	0.2	2.1	3.1	0.2	0.7		0.1	1.9	0.0	0.6	0.7	4.9		16.9
Luxembourg	L	0.2	0.2	0.1	0.0	0.4	0.6	0.0	0.1	0.2		0.4	0.0	0.1	0.1	0.9		3.4
Netherlands	NL	3.4	3.0	1.3	0.5	6.5	9.6	0.7	2.0	3.1	0.4		0.0	1.8	2.1	15.2		49.6
Portugal	P	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0		0.1
Spain	E	1.1	0.9	0.4	0.2	2.0	3.0	0.2	0.6	1.0	0.1	1.9	0.0		0.7	4.8		16.9
Sweden	SWE	0.5	0.4	0.2	0.1	0.9	1.4	0.1	0.3	0.4	0.1	0.9	0.0	0.3		2.2		7.8
United Kingdom	UK	6.5	5.7	2.5	1.0	12.5	18.2	1.4	3.9	5.9	0.7	11.5	0.0	3.4	4.0			77.1
<i>Inward TD revenues ></i>		21.1	18.8	8.5	3.4	38.3	54.5	4.6	13.1	19.2	2.4	33.7	0.1	11.2	13.4	71.2		313.5

Notes 1 For each bilateral mail flow, cost equals volume (from table 4c) times CEPT terminal dues for destination post office (col 2a).

Table 5b. Estimated cost of outward mail at 55% domestic postage (1994)

		5ba	5bb	5bc	5bd	5be	5bf	5bg	5bh	5bi	5bj	5bk	5bl	5bm	5bn	5bo	5bp
		DESTINATION POST OFFICES															
Destination > 55% dom. postage>		A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK	Paid for outward SDR mil
		SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil
Austria	A		1.4	0.8	0.2	3.2	5.8	0.2	0.9	1.3	0.2	2.6	0.0	0.4	0.9	5.1	22.9
Belgium	B	1.2		0.5	0.2	2.1	3.8	0.1	0.6	0.9	0.1	1.7	0.0	0.2	0.6	3.4	15.3
Denmark	DK	1.1	0.9		0.1	2.0	3.6	0.1	0.6	0.8	0.1	1.6	0.0	0.2	0.5	3.2	14.7
Finland	FIN	0.2	0.2	0.1		0.4	0.7	0.0	0.1	0.2	0.0	0.3	0.0	0.0	0.1	0.6	3.0
France	F	3.2	2.5	1.4	0.4		10.4	0.3	1.6	2.3	0.3	4.7	0.0	0.7	1.6	9.2	38.5
Germany	D	3.9	3.1	1.7	0.5	7.1		0.3	2.0	2.9	0.3	5.7	0.0	0.8	1.9	11.3	41.6
Greece	GR	0.6	0.5	0.3	0.1	1.2	2.1		0.3	0.5	0.1	1.0	0.0	0.1	0.3	1.9	9.0
Ireland	IRL	0.5	0.4	0.2	0.1	1.0	1.7	0.0		0.4	0.0	0.8	0.0	0.1	0.3	1.5	7.2
Italy	I	1.4	1.1	0.6	0.2	2.6	4.6	0.1	0.7		0.1	2.1	0.0	0.3	0.7	4.1	18.7
Luxembourg	L	0.3	0.2	0.1	0.0	0.5	0.9	0.0	0.1	0.2		0.4	0.0	0.1	0.1	0.8	3.7
Netherlands	NL	4.4	3.5	1.9	0.6	8.0	14.3	0.4	2.3	3.3	0.4		0.0	0.9	2.2	12.8	54.9
Portugal	P	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0	0.1
Spain	E	1.4	1.1	0.6	0.2	2.5	4.5	0.1	0.7	1.0	0.1	2.0	0.0		0.7	4.0	19.0
Sweden	SWE	0.6	0.5	0.3	0.1	1.2	2.1	0.1	0.3	0.5	0.1	0.9	0.0	0.1		1.9	8.6
United Kingdom	UK	8.3	6.6	3.7	1.1	15.3	27.4	0.8	4.3	6.2	0.7	12.4	0.0	1.8	4.1		92.7
<i>Inward TD revenues ></i>		27.1	22.0	12.3	3.9	46.9	81.8	2.5	14.5	20.4	2.4	36.2	0.0	5.8	14.0	59.8	349.8

Notes 1 For each bilateral mail flow, cost equals volume (from table 4c) times 55% of domestic postage for destination post office (col 2d).

Table 5c. Estimated cost of outward mail at 65% domestic postage (1994)

		5ca	5cb	5cc	5cd	5ce	5cf	5cg	5ch	5ci	5cj	5ck	5cl	5cm	5cn	5co	5cp		
		DESTINATION POST OFFICES																	
Destination > 65% dom. postage>		A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK		Outward totals	
		SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil
Austria	A		1.7	0.9	0.3	3.8	6.8	0.2	1.1	1.5	0.2	3.1	0.0	0.4	1.0	6.1		27.1	
Belgium	B	1.4		0.6	0.2	2.5	4.5	0.1	0.7	1.0	0.1	2.0	0.0	0.3	0.7	4.0		18.0	
Denmark	DK	1.3	1.0		0.2	2.3	4.2	0.1	0.7	1.0	0.1	1.9	0.0	0.3	0.6	3.7		17.4	
Finland	FIN	0.3	0.2	0.1		0.5	0.8	0.0	0.1	0.2	0.0	0.4	0.0	0.1	0.1	0.7		3.5	
France	F	3.7	3.0	1.7	0.5		12.2	0.3	1.9	2.8	0.3	5.5	0.0	0.8	1.8	10.9		45.5	
Germany	D	4.6	3.6	2.0	0.6	8.4		0.4	2.4	3.4	0.4	6.8	0.0	1.0	2.3	13.4		49.1	
Greece	GR	0.8	0.6	0.3	0.1	1.4	2.5		0.4	0.6	0.1	1.1	0.0	0.2	0.4	2.2		10.6	
Ireland	IRL	0.6	0.5	0.3	0.1	1.1	2.1	0.1		0.5	0.1	0.9	0.0	0.1	0.3	1.8		8.5	
Italy	I	1.7	1.3	0.7	0.2	3.0	5.5	0.1	0.9		0.1	2.5	0.0	0.3	0.8	4.9		22.1	
Luxembourg	L	0.3	0.3	0.1	0.0	0.6	1.0	0.0	0.2	0.2		0.5	0.0	0.1	0.2	0.9		4.4	
Netherlands	NL	5.2	4.1	2.3	0.7	9.5	17.0	0.5	2.7	3.8	0.4		0.0	1.1	2.6	15.1		64.9	
Portugal	P	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0		0.2	
Spain	E	1.6	1.3	0.7	0.2	3.0	5.3	0.1	0.8	1.2	0.1	2.4	0.0		0.8	4.7		22.4	
Sweden	SWE	0.7	0.6	0.3	0.1	1.4	2.5	0.1	0.4	0.6	0.1	1.1	0.0	0.2		2.2		10.1	
United Kingdom	UK	9.9	7.8	4.4	1.4	18.0	32.4	0.9	5.1	7.3	0.8	14.6	0.0	2.1	4.9			109.5	
<i>Inward TD revenues ></i>		32.0	26.0	14.6	4.6	55.4	96.7	3.0	17.2	24.1	2.9	42.8	0.1	6.8	16.5	70.7		413.4	

Notes 1 For each bilateral mail flow, cost equals volume (from table 4c) times 65% of domestic postage for destination post office (col 2e).

Table 5d. Estimated cost of outward mail at 70% domestic postage (1994)

		5da	5db	5dc	5dd	5de	5df	5dg	5dh	5di	5dj	5dk	5dl	5dm	5dn	5do	5dp		
		DESTINATION POST OFFICES																	
Destination > 70% dom. postage>		A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK		Outward totals	
		SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil
Austria	A		1.8	1.0	0.3	4.1	7.3	0.2	1.2	1.7	0.2	3.3	0.0	0.5	1.1	6.5		29.2	
Belgium	B	1.5		0.7	0.2	2.7	4.8	0.1	0.8	1.1	0.1	2.2	0.0	0.3	0.7	4.3		19.4	
Denmark	DK	1.4	1.1		0.2	2.5	4.5	0.1	0.7	1.0	0.1	2.0	0.0	0.3	0.7	4.0		18.7	
Finland	FIN	0.3	0.2	0.1		0.5	0.9	0.0	0.1	0.2	0.0	0.4	0.0	0.1	0.1	0.8		3.8	
France	F	4.0	3.2	1.8	0.6		13.2	0.4	2.1	3.0	0.3	5.9	0.0	0.8	2.0	11.7		49.0	
Germany	D	4.9	3.9	2.2	0.7	9.0		0.4	2.5	3.7	0.4	7.3	0.0	1.0	2.4	14.4		52.9	
Greece	GR	0.8	0.7	0.4	0.1	1.5	2.7		0.4	0.6	0.1	1.2	0.0	0.2	0.4	2.4		11.4	
Ireland	IRL	0.7	0.5	0.3	0.1	1.2	2.2	0.1		0.5	0.1	1.0	0.0	0.1	0.3	2.0		9.1	
Italy	I	1.8	1.4	0.8	0.2	3.3	5.9	0.2	0.9		0.2	2.7	0.0	0.4	0.9	5.2		23.8	
Luxembourg	L	0.3	0.3	0.2	0.0	0.6	1.1	0.0	0.2	0.3		0.5	0.0	0.1	0.2	1.0		4.7	
Netherlands	NL	5.6	4.4	2.5	0.8	10.2	18.3	0.5	2.9	4.1	0.5		0.0	1.2	2.8	16.3		69.9	
Portugal	P	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0		0.2	
Spain	E	1.7	1.4	0.8	0.2	3.2	5.7	0.2	0.9	1.3	0.1	2.6	0.0		0.9	5.1		24.2	
Sweden	SWE	0.8	0.6	0.4	0.1	1.5	2.6	0.1	0.4	0.6	0.1	1.2	0.0	0.2		2.4		10.9	
United Kingdom	UK	10.6	8.4	4.7	1.5	19.4	34.8	1.0	5.5	7.9	0.9	15.7	0.0	2.2	5.3			118.0	
<i>Inward TD revenues ></i>		34.4	28.0	15.7	5.0	59.7	104.1	3.2	18.5	25.9	3.1	46.0	0.1	7.4	17.8	76.2		445.2	

Notes 1 For each bilateral mail flow, cost equals volume (from table 4c) times 70% of domestic postage for destination post office (col 2f).

Table 5e. Estimated cost of outward mail at 80% domestic postage (1994)

		5ea	5eb	5ec	5ed	5ee	5ef	5eg	5eh	5ei	5ej	5ek	5el	5em	5en	5eo	5ep	
		DESTINATION POST OFFICES																
Destination >		A	B	DK	FIN	F	D	GR	IRL	I	L	NL	P	E	SWE	UK		Outward
80% dom. postage>		0.32	0.29	0.36	0.29	0.30	0.37	0.14	0.28	0.26	0.25	0.27	0.15	0.13	0.26	0.21		totals
		SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil	SDR mil		SDR mil
Austria	A		2.0	1.1	0.4	4.7	8.4	0.2	1.3	1.9	0.2	3.8	0.0	0.5	1.3	7.5		33.3
Belgium	B	1.7		0.7	0.2	3.1	5.5	0.2	0.9	1.2	0.1	2.5	0.0	0.4	0.8	4.9		22.2
Denmark	DK	1.6	1.3		0.2	2.9	5.2	0.1	0.8	1.2	0.1	2.3	0.0	0.3	0.8	4.6		21.4
Finland	FIN	0.3	0.2	0.1		0.6	1.0	0.0	0.2	0.2	0.0	0.5	0.0	0.1	0.2	0.9		4.3
France	F	4.6	3.7	2.0	0.6		15.1	0.4	2.4	3.4	0.4	6.8	0.0	1.0	2.3	13.4		56.0
Germany	D	5.6	4.5	2.5	0.8	10.3		0.5	2.9	4.2	0.5	8.3	0.0	1.2	2.8	16.4		60.5
Greece	GR	0.9	0.7	0.4	0.1	1.7	3.1		0.5	0.7	0.1	1.4	0.0	0.2	0.5	2.7		13.1
Ireland	IRL	0.8	0.6	0.3	0.1	1.4	2.5	0.1		0.6	0.1	1.1	0.0	0.2	0.4	2.3		10.4
Italy	I	2.0	1.6	0.9	0.3	3.7	6.7	0.2	1.1		0.2	3.0	0.0	0.4	1.0	6.0		27.2
Luxembourg	L	0.4	0.3	0.2	0.1	0.7	1.3	0.0	0.2	0.3		0.6	0.0	0.1	0.2	1.1		5.4
Netherlands	NL	6.4	5.1	2.8	0.9	11.6	20.9	0.6	3.3	4.7	0.5		0.0	1.3	3.2	18.6		79.9
Portugal	P	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	0.0		0.2
Spain	E	2.0	1.6	0.9	0.3	3.7	6.6	0.2	1.0	1.5	0.2	3.0	0.0		1.0	5.8		27.6
Sweden	SWE	0.9	0.7	0.4	0.1	1.7	3.0	0.1	0.5	0.7	0.1	1.4	0.0	0.2		2.7		12.5
United Kingdom	UK	12.1	9.7	5.4	1.7	22.2	39.8	1.1	6.2	9.0	1.0	18.0	0.0	2.6	6.0			134.8
<i>Inward TD revenues ></i>		39.4	32.0	18.0	5.7	68.2	119.0	3.7	21.2	29.6	3.6	52.6	0.1	8.4	20.3	87.0		508.8

Notes 1 For each bilateral mail flow, cost equals volume (from table 4c) times 80% of domestic postage for destination (col 2g).

Table 6. Summary of net profit or loss on TDs at various TD levels

		6a	6b	6c	6d	6e	6f	6g	6h	6i	6j	6k	6l	6m	6n	6o
		CEPT			55 PERCENT			65 PERCENT			70 PERCENT			80 PERCENT		
		Outward Cost mil SDR	Inward Revenue mil SDR	Net Profit (cost) mil SDR	Outward Cost mil SDR	Inward Revenue mil SDR	Net Profit (cost) mil SDR	Outward Cost mil SDR	Inward Revenue mil SDR	Net Profit (cost) mil SDR	Outward Cost mil SDR	Inward Revenue mil SDR	Net Profit (cost) mil SDR	Outward Cost mil SDR	Inward Revenue mil SDR	Net Profit (cost) mil SDR
Austria	A	21.0	21.1	0.14	22.9	27.1	4.2	27.1	32.0	4.9	29.2	34.4	5.3	33.3	39.4	6.0
Belgium	B	13.9	18.8	4.92	15.3	22.0	6.7	18.0	26.0	8.0	19.4	28.0	8.6	22.2	32.0	9.8
Denmark	DK	13.4	8.5	-4.97	14.7	12.3	-2.4	17.4	14.6	-2.8	18.7	15.7	-3.0	21.4	18.0	-3.4
Finland	FIN	2.7	3.4	0.67	3.0	3.9	0.9	3.5	4.6	1.1	3.8	5.0	1.2	4.3	5.7	1.4
France	F	35.4	38.3	2.87	38.5	46.9	8.4	45.5	55.4	9.9	49.0	59.7	10.7	56.0	68.2	12.2
Germany	D	40.7	54.5	13.77	41.6	81.8	40.3	49.1	96.7	47.6	52.9	104.1	51.2	60.5	119.0	58.6
Greece	GR	8.1	4.6	-3.46	9.0	2.5	-6.4	10.6	3.0	-7.6	11.4	3.2	-8.2	13.1	3.7	-9.4
Ireland	IRL	6.5	13.1	6.63	7.2	14.5	7.4	8.5	17.2	8.7	9.1	18.5	9.4	10.4	21.2	10.7
Italy	I	16.9	19.2	2.33	18.7	20.4	1.7	22.1	24.1	2.0	23.8	25.9	2.1	27.2	29.6	2.4
Luxembourg	L	3.4	2.4	-0.97	3.7	2.4	-1.3	4.4	2.9	-1.5	4.7	3.1	-1.6	5.4	3.6	-1.8
Netherlands	NL	49.6	33.7	-15.87	54.9	36.2	-18.7	64.9	42.8	-22.1	69.9	46.0	-23.8	79.9	52.6	-27.2
Portugal	P	0.1	0.1	-0.04	0.1	0.0	-0.1	0.2	0.1	-0.1	0.2	0.1	-0.1	0.2	0.1	-0.1
Spain	E	16.9	11.2	-5.74	19.0	5.8	-13.2	22.4	6.8	-15.6	24.2	7.4	-16.8	27.6	8.4	-19.2
Sweden	SWE	7.8	13.4	5.60	8.6	14.0	5.4	10.1	16.5	6.4	10.9	17.8	6.9	12.5	20.3	7.8
United Kingdom	UK	77.1	71.2	-5.88	92.7	59.8	-32.9	109.5	70.7	-38.8	118.0	76.2	-41.8	134.8	87.0	-47.8
		313.5	313.5	0.0	349.8	349.8	0.0	413.4	413.4	0.0	445.2	445.2	0.0	508.8	508.8	0.0

Notes 1 Outward TD costs are from column p in Tables 5a, 5b, 5c, 5d, and 5e.

2 Inward TD revenues are from row "Inward TD revenues" in Tables 5a, 5b, 5c, 5d, and 5e.

Table 7. Net gain or loss from incorrect TDs compared to 80% TDs

Assumes that 80 percent of domestic postage is correct TD level

		7a	7b	7c	7d	7e	7f	7g	7h	7i	7j	7k	7l
		Loss/profit: CEPT			Loss/profit: 55% Dom Post			Loss/profit: 65% Dom Post			Loss/profit: 70% Dom Post		
		Net SDR mil	Loss SDR mil	Profit SDR mil	Net SDR mil	Loss SDR mil	Profit SDR mil	Net SDR mil	Loss SDR mil	Profit SDR mil	Net SDR mil	Loss SDR mil	Profit SDR mil
Austria	A	-5.90	-5.90	-	-1.89	-1.89	-	-1.13	-1.13	-	-0.75	-0.75	-
Belgium	B	-4.88	-4.88	-	-3.06	-3.06	-	-1.84	-1.84	-	-1.22	-1.22	-
Denmark	DK	-1.54	-1.54	-	1.07	-	1.07	0.64	-	0.64	0.43	-	0.43
Finland	FIN	-0.70	-0.70	-	-0.43	-0.43	-	-0.26	-0.26	-	-0.17	-0.17	-
France	F	-9.35	-9.35	-	-3.82	-3.82	-	-2.29	-2.29	-	-1.53	-1.53	-
Germany	D	-44.79	-44.79	-	-18.30	-18.30	-	-10.98	-10.98	-	-7.32	-7.32	-
Greece	GR	5.92	-	5.92	2.93	-	2.93	1.76	-	1.76	1.17	-	1.17
Ireland	IRL	-4.12	-4.12	-	-3.36	-3.36	-	-2.02	-2.02	-	-1.34	-1.34	-
Italy	I	-0.10	-0.10	-	-0.76	-0.76	-	-0.46	-0.46	-	-0.30	-0.30	-
Luxembourg	L	0.87	-	0.87	0.58	-	0.58	0.35	-	0.35	0.23	-	0.23
Netherlands	NL	11.36	-	11.36	8.51	-	8.51	5.11	-	5.11	3.40	-	3.40
Portugal	P	0.08	-	0.08	0.04	-	0.04	0.02	-	0.02	0.02	-	0.02
Spain	E	13.46	-	13.46	6.00	-	6.00	3.60	-	3.60	2.40	-	2.40
Sweden	SWE	-2.24	-2.24	-	-2.45	-2.45	-	-1.47	-1.47	-	-0.98	-0.98	-
United Kingdom	UK	41.91	-	41.91	14.93	-	14.93	8.96	-	8.96	5.97	-	5.97
		0.00	-73.6	73.6	0.00	-34.1	34.1	0.00	-20.4	20.4	0.0	-13.6	13.6

Notes 1 Cols 6a, 6d, 6g, 6j, and 6m: Net loss or profit from use of the various incorrect TD schemes is the net cost or profit resulting from the incorrect TD scheme (col 2c for CEPT, col 10c for TDs = 55% domestic postage, col 10f for TDs = 65% domestic postage, and col 10i for TDs = 70% domestic postage) minus the net cost or profit that would have resulted from use of the correct TD scheme, assumed to be 80 percent of domestic postage (col 11(l)).

Table 8. Relative impact of shifting from CEPT to 80% domestic postage

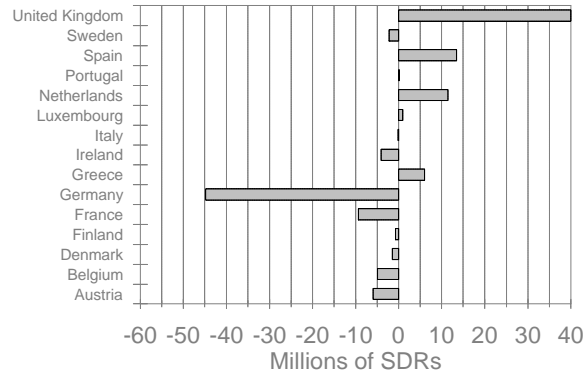
		8a	8b	8c	8d	8e
		Net Gain/ Loss SDR mil	Est. Int'l Mail Revenue SDR mil	Gain/loss % of Intl Revenue	Est. Domestic Revenue SDR mil	Gain/loss % of Dom. Revenue
Austria	A	5.90	73	8%	564	1.05%
Belgium	B	4.88	44	11%	405	1.20%
Denmark	DK	1.54	53	3%	420	0.37%
Finland	FIN	0.70	9	8%	273	0.26%
France	F	9.35	117	8%	2,378	0.39%
Germany	D	44.79	166	27%	4,321	1.04%
Greece	GR	-5.92	12	-49%	18	-33.15%
Ireland	IRL	4.12	19	21%	151	2.72%
Italy	I	0.10	48	0%	2,176	0.00%
Luxembourg	L	-0.87	9	-9%	33	-2.67%
Netherlands	NL	-11.36	145	-8%	2,099	-0.54%
Portugal	P	-0.08	0	-41%	4	-1.81%
Spain	E	-13.46	24	-57%	445	-3.02%
Sweden	SWE	2.24	22	10%	464	0.48%
United Kingdom	UK	-41.91	187	-22%	2,230	-1.88%
		0.00	929	0%	15,982	0.00%

- Notes
- 1 Col 8a: net gain or loss from shifting from CEPT to 80% domestic postage is negative of by a post office under the CEPT scheme, as calculated in col 6c.
 - 2 Col 8b: Estimated international mail revenue is outward mail volume (EU and non-EU) (col 1b) times domestic postage in SDRs (col 3c).
 - 3 Col 8d: Estimated domestic mail revenue is domestic mail volume (col 1a) times domesti

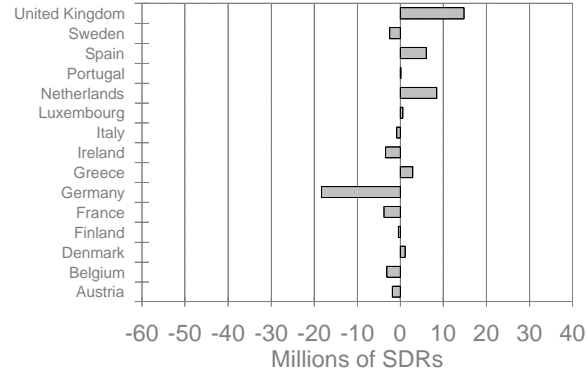
Table 9. Sources of distortion due to CEPT terminal dues

		9a	9b	9c	9d	9e	9f	9g	9h	9i	9j	9k
		CEPT TDS			80 PERCENT TDS			Net	Under	Over	CEPT payment as percent	
		Outward	Inward	Net	Outward	Inward	Net	gain (loss)	(over)payment	(under)payment	Outward mail	Inward mail
		Cost	Revenue	Profit (cost)	Cost	Revenue	Profit (cost)	due to CEPT	outward mail	inward mail	costs	revenues
		mil SDR	mil SDR	mil SDR	mil SDR	mil SDR	mil SDR	mil SDR	mil SDR	mil SDR		
Austria	A	21.0	21.1	0.14	33.3	39.4	6.0	-5.9	12.3	-18.2	63%	54%
Belgium	B	13.9	18.8	4.92	22.2	32.0	9.8	-4.9	8.3	-13.2	63%	59%
Denmark	DK	13.4	8.5	-4.97	21.4	18.0	-3.4	-1.5	8.0	-9.5	63%	47%
Finland	FIN	2.7	3.4	0.67	4.3	5.7	1.4	-0.7	1.6	-2.3	62%	59%
France	F	35.4	38.3	2.87	56.0	68.2	12.2	-9.4	20.6	-29.9	63%	56%
Germany	D	40.7	54.5	13.77	60.5	119.0	58.6	-44.8	19.7	-64.5	67%	46%
Greece	GR	8.1	4.6	-3.46	13.1	3.7	-9.4	5.9	5.0	0.9	62%	126%
Ireland	IRL	6.5	13.1	6.63	10.4	21.2	10.7	-4.1	3.9	-8.0	62%	62%
Italy	I	16.9	19.2	2.33	27.2	29.6	2.4	-0.1	10.3	-10.4	62%	65%
Luxembourg	L	3.4	2.4	-0.97	5.4	3.6	-1.8	0.9	2.0	-1.2	62%	67%
Netherlands	NL	49.6	33.7	-15.87	79.9	52.6	-27.2	11.4	30.3	-18.9	62%	64%
Portugal	P	0.1	0.1	-0.04	0.2	0.1	-0.1	0.1	0.1	0.0	62%	113%
Spain	E	16.9	11.2	-5.74	27.6	8.4	-19.2	13.5	10.7	2.8	61%	133%
Sweden	SWE	7.8	13.4	5.60	12.5	20.3	7.8	-2.2	4.7	-7.0	62%	66%
United Kingdom	UK	77.1	71.2	-5.88	134.8	87.0	-47.8	41.9	57.7	-15.8	57%	82%
		313.5	313.5	0.0	508.8	508.8	0.0	0.0	195.3	-195.3	62%	62%

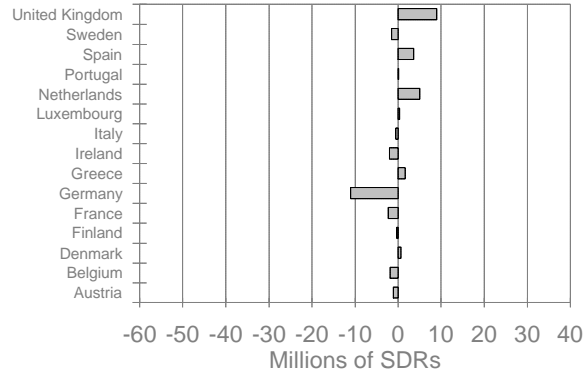
Loss/Profit At TDs = CEPT TDs



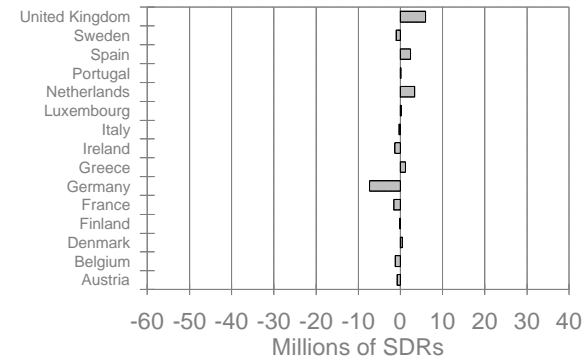
Loss/Profit At TDs = 55% Domestic Post



Loss/Profit At TDs = 65% Domestic Post



Loss/Profit At TDs = 70% Domestic Post



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5

Financing Postal Acquisitions (1999)*

Note: The following Report and Final Order from the General Regulatory Commission is imaginary. It is intended to illustrate some of the issues and legal considerations raised by the acquisition of private companies by public post offices.

Before the General Regulatory Commission
PP Docket 99-123

In the Matter of:
Financing Postal Acquisitions: General Principles

REPORT AND FINAL ORDER
24 June 1999

By the Commission:

1. BACKGROUND

Around the world public postal operators are expanding beyond traditional postal services by entering adjoining competitive sectors, in many cases by acquiring private companies already in the field. These moves are driven by the logic of changing technology. For more than three centuries, the central mission of public post offices has been the carriage of letters, and the fundamental means of financing public post offices has been a monopoly over the carriage of letters. Electronic alternatives now threaten the continued viability of this core mission. There can be no doubt traffic in letters committed to paper will decline.

Our national Post Office (PO) is not immune from these trends. After long hesitation, PO is now seeking to prepare itself for a non-monopolized, privatized

*Paper presented at Rutgers University, Center for Research in Regulated Industries, Current Directions in Postal Reform, Sintra, Portugal, June 1999.

future in which it will, of necessity, depend upon a different mix of delivery and other services. As the Postmaster General has said:

we will not retain our monopoly forever. *We will lose this monopoly. It's happening all over the world.* Monopolies are being deregulated. . . . We need to prepare . . . by getting our act together on how this organization needs to be deregulated—and it needs to be deregulated. It needs to be commercialized.¹

A major step in PO's plan to adapt to the future is its proposed acquisition of Zoom Express and Logistics Company (Zoom). Zoom is a large provider of international express, freight, and logistics services headquartered in Cousteauville, Tahiti. PO proposes to purchase and operate Zoom through its wholly owned private law subsidiary, Postal Logistics Corporation (PLC). According to PO, by acquiring Zoom, PO will diversity its product line, obtain an international distribution network, and, most importantly, enlist in its ranks a corp of managers experienced in private sector competition.

In order to finance the purchase of Zoom, PO proposes to draw on several sources of funds. First, PO the bulk of substantial profits earned last year are to devoted to the purchase of Zoom. Second, PO will sell real estate which has appreciated substantially and is no longer used for postal purposes. Third, the Post Office plans to borrow the remainder from commercial sources.

In compliance with the Commission's rules relating to large investments, PO gave the Commission advance notice of its intentions on February 4, 1999. On February 21, 1999, the Commission issued a public summary PO's plans and requested comments.

In response, several private delivery services, consumer groups, and the Department of Justice (DOJ) have raised questions about whether PO's plan to finance the purchase of Zoom is consistent with its obligation to provide "just and reasonable" rates for regulated postal services. PO, together with several of its largest customers, have defended the principles of its financing plan in all respects.

On March 21, 1999, we issued a Notice of Inquiry on the general principles raised by PO's acquisition, in whole or substantial part, of private companies that engage, in whole or in part, in non-postal activities. Because of the importance of issues raised in this docket, on May 23, an oral hearing was held before the full Commission. After consideration of all comments submitted, we have decided to allow in part and to deny in the complaints filed in this docket and to provide general guidelines for the financing of such acquisitions by PO, as set out below.

2. LEGAL FRAMEWORK

The national Post Office (PO) is established as a government agency whose assets are owned by the Government. The Government has appointed a Board of

¹Postmaster General William J. Henderson, Remarks at the National Postal Forum, Washington, D.C. (August 31, 1998). Throughout this paper, underscoring in quoted material indicates emphasis by the author of this paper unless otherwise indicated.

Directors to oversee its ownership interest.

Under national law, PO benefits from certain legal privileges and labors under certain legal obligations. PO is the beneficiary of a legal monopoly over the carriage of letters and enjoys special privileges under other laws as well, such as tax and customs laws.

In addition to letter delivery, PO provides a number of other postal services, including the delivery of advertising mail, newspapers, parcels, and express items. These services are considered “postal” because most of the costs of production are incurred in common with the costs of the letter service. In some non-letter postal services, such as the delivery of advertising mail, PO has a de facto monopoly by virtue of economies of scale permitted by its monopoly over letter mail. Monopoly and de facto non-competitive services are collectively referred to as “non-competitive” postal services. In other non-monopoly postal services, such as delivery of express items and parcels, PO faces competition from private operators. Such services are referred to “competitive” postal services.

Under national law, PO is obliged to provide universal service for all non-competitive postal services. That is, PO must meet any reasonable demand for service to all locations in the country under minimum standards of quality at affordable rates. PO is not obliged by law to provide competitive postal services because, by definition, if PO fails to provide the needed service others are available to do so.

In addition to postal services, PO offers a small amount of non-postal services through a structurally separate subsidiary, Postal Logistics Corporation (PLC). PLC was established in compliance with this Commission’s decision last year in *Non-Postal Services Investigation*. See paragraph , below. PLC presently provides email service, a remittance processing service, and chain of upscale book stores. PLC enjoys none of the legal privileges or obligations of PO proper.

This Commission has been established as an independent agency to ensure that rates charged by public undertakings owned or licensed by the Government are “just and reasonable” in sectors where competition is substantially diminished by special or exclusive statutory rights. Under this statute, this Commission has long exercised jurisdiction over postal services provided by PO.

This inquiry presents several issues of first impression. While we have heretofore overseen rates charged by PO, PO has for the most part confined its activities to the direct supply of traditional postal services. This is the first occasion on which PO has proposed acquisition of a large company engaged in postal and non-postal services.

On the other hand, this Commission has extensive experience with similar issues in other sectors, most particularly in the telecommunications sector. Prior to the mid 1960s, the national telecommunications market was dominated by single supplier, AT&T. A privately owned company, AT&T was until then the only major telephone company licensed by the Commission. New technologies, however, brought new types of competition and new competitors. In a long series of proceedings, this Commission devised rules to allow, and require, AT&T to make

the difficult transition from national monopolist to competitive entity. Of necessity, we struck a delicate balance between allowing a monopolist to compete while preventing it from using its monopoly to gain unfair advantage, all the while ensuring the continuity of public services provided by the national telecommunications system. From a regulatory standpoint, the task of unwinding a national postal monopoly is similar. Moreover, in addition to our experience in the telecommunications sector, we have been able to draw upon other jurisprudence which addresses several of the issues raised in this case.

3. FINANCING FROM CURRENT PROFITS

The first source of financing proposed by PO is earnings from last year's highly successful operations, which yielded a profit of \$ 1 billion on total revenues of \$50.2 billion, as follows:

Table 1. Summary of PO's costs and revenue

	\$ million
<i>Revenues</i>	
Post Office	
Non-competitive	30,000
Competitive	20,000
Postal Logistics Corp.	200
Total revenues	50,200
<i>Costs</i>	
Post Office	49,010
Postal Logistics Corp.	190
Total costs	49,200
<i>Profits</i>	1,000

The complainants, however, question the propriety of PO using these profits to finance the acquisition of Zoom instead of reducing future postal rates. In order to evaluate these arguments, we must first decide how to allocate PO's overall profit among the three sources of revenue. This task, in turn, requires two types of accounting tools: (i) rules for transactions between PO and its non-postal subsidiary, and (ii) rules for allocation of costs of postal products.²

3.1 PLC'S PROFITS

As noted above, last year PLC reported profits of \$10 million dollars on revenues of \$200 million.

The regulatory treatment of PLC's profits is straightforward. In *Non-Postal*

²Federal Communications Commission, *Separation of Cost of Regulated Telephone Service from Costs of Nonregulated Activities*, 104 FCC 2d 59, 61 (1986) (notice of proposed rulemaking) (hereafter, *Joint Cost Order*). The decision in the text follows the analytical approach of the Federal Communications Commission (FCC) in accounting for common costs incurred by telecommunications companies that providing both regulated and unregulated services. Note that a single FCC proceeding may include several orders.

Services Investigation, we ordered PO to transfer all non-postal services to a structurally separate subsidiary. Our rationale for this order was explained as follows:

*In replying on a structural approach to address our regulatory concerns, the primary benefits of the policy are protection for the regulated market ratepayer against costs transferred from the competitive market by the parent corporation, and protection for the general public against such anticompetitive activities as denial of access and predatory pricing. The magnitude of these benefits is not susceptible to precise quantification, but we do expect it to be substantial. The opportunities for undetected cross-subsidization that prevail in the absence of a separation requirement are so substantial that, at a minimum, protection from such abuses is very important to the [postal] ratepayer. The general public would realize benefits equally substantial, if less immediate.*³

³Federal Communications Commission, *Amendment of Section 64.702 of the Commission's Rules and Regulations*, 77 FCC 2d 385, 463 (1980) (hereafter *Computer II*), summarizing the reasoning of the FCC in *Regulatory and Policy Problems Presented by the Interdependence of Computer and Communication Services and Facilities*, known as the *Computer I* decision. In *Computer I*, 28 FCC 2d 267 (1971), the FCC concluded that "the data processing industry has become a major force in the American economy" and that "there is a close and intimate relationship between data processing and communications services." 28 FCC 2d at 268-69. The FCC was concerned primarily about "the alleged ability of common carriers to favor their own data processing activities by discriminatory services, cross-subsidization, improper pricing of common carrier services, and related anti-competitive practices and activities." 28 FCC 2d at 270. The FCC considered and rejected an outright prohibition against provision of data processing services by telecommunications carriers. As a compromise, the FCC decided that structural separation between regulated and unregulated activities would allow it to perform its regulatory responsibilities. The courts upheld FCC authority to order structural separation in *GTE Service Corporation v. F.C.C.*, 474 F.2d 724 (D.C. Cir. 1973).

In *Computer II*, the FCC decided that telecommunications and computers had become so intertwined that structural separation was no longer workable and accounting separation was required instead. Nonetheless, the FCC has continued to require structural separation in other contexts, such as the supply of customer premises equipment and "enhanced" telecommunications services by dominant carriers such as AT&T and GTE. *Computer II* was upheld by the courts in *Computer and Communications Industry Association v. F.C.C.*, 693 F.2d 198 (D.C. Cir. 1982).

As a remedial device, structural separation has a long history in the telecommunications industry. In 1949, an FCC investigation led the government to file an antitrust suit against AT&T. The complaint alleged that AT&T had monopolized and conspired to restrain trade in the manufacture, distribution, sale, and installation of telephones, telephone apparatus, equipment, materials, and supplies. The relief sought included the divestiture by AT&T of its stock ownership in Western Electric (equipment manufacturer); termination of exclusive relationships between AT&T and Western Electric; divestiture by Western Electric of its fifty percent interest in Bell Telephone Laboratories; separation of telephone manufacturing from the provision of telephone service; and the compulsory licensing of patents owned by AT&T on a non-discriminatory basis. The case was settled by a consent decree in 1956 that left in place AT&T's de facto monopoly and its relationship with Western Electric, but prohibited AT&T from branching into other lines of business and limited Western Electric to servicing AT&T. In 1974, the government filed a second antitrust case against AT&T, concluding that the 1956 consent decree was inadequate. In 1982, the Department of Justice and AT&T agreed on a second consent decree. The 1982 consent decree broke up AT&T into a long distance company and several local operating companies as of January 1, 1984. *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom. Maryland v. United States*, 460 U.S. 1001

At the same, we established rules to account for transactions between PO and its non-postal subsidiary. Accordingly, all transactions must be recorded in writing and fully “compensatory” where *compensatory* means:

that for each transaction, the parent corporation or affiliated entity must recover from its subsidiary *the full cost of the transferred goods or services at the same terms, prices, and conditions that would be available to a nonaffiliated purchaser if third-party transactions were required*. Since the parent would expect to earn reasonable profits on third-party transactions, it will be expected to earn similar profits on intracorporate transfers. Since it would expect to recover transaction costs and overhead loadings in its third-party transactions, it will be expected to make similar recoveries in its intracorporate transfers.⁴

Based on our examination of PO’s accounts, we find that PO has followed these guidelines with respect to the transactions with PLC. Hence, we conclude that \$10 million in profits reported by PLC is correctly stated and beyond our jurisdiction. All of these funds may be devoted by PO to the purchase in a private company such as Zoom.

3.2 PO’S PROFITS FROM POSTAL SERVICES

Last year, PO earned \$ 50 billion in revenues and incurred \$ 49.01 billion costs, yielding an overall profit on postal services of \$ 990 million.⁵

As a general rule, of course, “just and reasonable” rates for a commercial organization include a reasonable profit on invested capital. Without such profits, no

(1983).

In H.R. 22, the Postal Modernization Act, 106th Congress, 1st Session, House Postal Service Subcommittee Chairman John McHugh has proposed application many of the regulatory reforms developed by the FCC to the postal sector. Section 204 of H.R. 22 provides for structural separation for the Postal Service’s non-postal activities and acquisitions of private companies.

⁴*Computer II*, 84 FCC 2d 50, 79 (1980). Section 204 of H.R. 22, adding §2012(f), imposes a similar requirement on relations between the Postal Service and its private law corporation.

⁵U.K. Post Office, “Pledges To Be A Top Player In New ‘Superleague’ - ‘The Gloves Are Coming Off’ In Battle For International Postal Market” (19 January 1989) makes clear that U.K. Post Office is acquiring private companies using current profits.

John Roberts, Chief Executive of The British Post Office, today predicted an elite “superleague” of post offices shaping up across the world—and vowed that Britain would be a leading player. . . . And he said that last week’s announcement of The British Post Office’s take-over of German Parcel, the third largest private carrier in Germany, with annual sales of £250 million, was clear evidence of The Post Office’s commitment to be a member of that elite league. . . . The UK Government announced in December that it would give The Post Office, which is still nationalised, more commercial freedom, to help strengthen its position for the “superleague” race. . . . *The Government is reducing the amount of money it takes from The Post Office’s annual profits, giving the business around £1 billion extra to invest over the next five years.*

capital would be invested. Applicability of this maxim to postal services, however, is not self-evident. In establishing PO, the Government has not risked its own money in the same sense as private investors risk their money. Rather, Government has spent money collected in taxes. Moreover, for non-competitive services, there is no risk associated with the Government's investment since the Government has precluded competition by law. On the other hand, while PO's non-competitive services do not need to return a profit to compensate investors, non-competitive services must generate sufficient funds to pay the cost of public service obligations which PO is legally required to discharge. Moreover, as far as competitive postal services are concerned, if PO did not earn a reasonable profit, it would have an artificial price advantage over private competitors.

In *First Postal Rates Investigation*, we concluded that "just and reasonable" rates would be maintained if PO's non-competitive postal services are priced so that, over the long run, revenues equal costs and no profits are earned. In other words, PO should earn sufficient "profits" on commercially profitable services to offset losses incurred in discharging public service obligations. Competitive postal services were regarded as ancillary to the non-competitive services, so costs and revenues for competitive products were included this general formula.⁶

In *Second Postal Rates Investigation*, we recognized the growing importance of competitive postal services to PO's business structure. We instructed PO to record costs and revenues according to a new system of accounts that distributes postal costs to one of two broad categories: non-competitive postal services or competitive postal services. At the same time, we allowed PO more flexibility in setting rates for competitive postal services. These accounting rules provide

a hierarchy of principles which should be used in the allocation of costs: that dedicated costs should be directly assigned; that common costs should be allocated based upon a direct measure of relative use if possible, otherwise on an indirect measure of use; and that if no adequate direct or indirect measure could be devised, then a general allocator should be used.⁷

The general allocator "allocates overhead costs in proportion to the costs that can be

⁶Under current U.S. law, the Postal Service is required to equate revenues to costs over the long run: "Postal rates and fees shall provide sufficient revenues so that the total estimated income and appropriations to the Postal Service will equal as nearly as practicable total estimated costs of the Postal Service." 39 USC 3621. Neither the Postal Service nor the Postal Rate Commission makes a distinction between non-competitive and competitive services.

⁷*Joint Cost Order*, FCC 86-564 at 1317 (1986). Section 203 of H.R. 22 would require accounting separation for non-competitive and competitive postal services by requiring the establishment of a "Competitive Products Fund." The Postal Service would be permitted to price competitive products freely provided (i) each price covers attributable costs and (ii) all competitive postal revenues collectively cover not only attributable costs but also a share of overhead costs that is at least proportional to the share of attributable costs generated by the competitive postal services (the "equal cost coverage" rule). Overall, in 1998, the Postal Service attributed 63 percent of all costs and, in other words, had a cost coverage of 159 percent. HR 22 further provides for adjustments in cost coverage by the Postal Rate Commission.

directly attributed to various services.”⁸ This fully distributed costing methodology is used only to separate costs between non-competitive and competitive categories; we have not required it as the basis for setting rates for individual non-competitive or competitive postal products.⁹

In prescribing this method of allocating costs, we explicitly rejected arguments of PO and some of its largest customers that urged incremental cost methods:

*Proponents of incremental approaches argue that full allocation of costs arbitrarily assigns costs to [competitive] activities regardless of whether the [competitive] activity caused the costs. They cite case law and academic authorities for the proposition that [fully distributed costing] is not required to prevent cross-subsidy and that the legal test applied by some courts in case involving communications common carriers has been whether the service covers its marginal costs. [PO] submits a paper purporting to demonstrate that marginal costing would promote efficient utilization of the network, prevent cross-subsidy, and promote competition. Several companies cite the line of antitrust cases applying the Areeda-Turner test for predation as support for the use of incremental costing.*¹⁰

Despite these powerful arguments, we explained our conclusion that a fully distributed costing approach was appropriate for allocating costs between non-competitive and competitive categories:

The reason for this is not that we deem full allocation to be synonymous with prevention of cross-subsidy. In fact, we do not entirely disagree with the parties who observe that cross-subsidy could, in theory, be avoided when all of the long run incremental costs of an activity are borne by the activity. However, we also agree with DOJ [Department of Justice] and others who argue that *our purposes should transcend prevention of cross-subsidy. Our goal of just and reasonable treatment of ratepayers requires that ratepayers participate in the economies of scale and scope which we believe can be achieved through integration of [competitive] services within the basic service*

⁸*Joint Cost Order*, FCC 86-564 at 1313 (1986). The FCC concluded, “Such a method closely approximates an economically efficient method if the elasticity of demand for the various outputs is not dissimilar.”

⁹In *Private Line Guideline Order*, 97 FCC 923 (1984), the FCC granted AT&T greater tariff flexibility because of the competition of new carriers such as MCI. See *Joint Cost Order*, 104 FCC 2d 59, 67-68 (1986).

¹⁰*Joint Cost Order*, FCC 86-564 at 1311 (1986). In FCC orders, the distinction is drawn between “regulated” activities and “unregulated” activities. Entry into regulated activities is limited by issuance of FCC licenses while entry into unregulated activities is not. The orders cited in the text relate accounting requirements for “regulated” and “unregulated” activities that share common costs. Thus, “regulated” and “unregulated” activities of telecommunications companies are similar to non-competitive postal services and competitive postal services. In the text, the imaginary General Regulatory Commission is assumed to have adopted an order applying a similar accounting regime to PO. To render this and following FCC quotations more readable, “non-competitive” and “competitive” have been substituted for “unregulated” and “regulated,” respectively; likewise, on occasion, “PO” has been substituted for “carrier” or “company” and “PLC for “unregulated subsidiary.”

network. It would not be just and reasonable to allow all of those economies to belong to [competitive] activities. We also agree with DOJ that there is no good reason why all residual costs of the [PO] should fall to the [competitive] sector. By the same token, we also disagree with the consumer advocates who seem to argue that all residual costs should fall upon [non-competitive] sectors. We are seeking to promote an equitable sharing of common costs. . .¹¹

The system of accounts provides special rules for major investment expenses, such as funds used to purchase large sorting equipment which can be used by both non-competitive and competitive postal items. We considered that investment costs:

are incurred in anticipation of future demand and . . . allocators based on even the most recently available pattern of relative use may result in large retrospective accounting adjustments when the cost are trued up to actual costs because of shifts in relative demand. The problem is most pronounced for investment costs since only a small portion of the investment will be recovered by the revenue from current use.¹²

Accordingly, we held that:

The allocation of central office equipment and outside plant investment cost between [non-competitive] and [competitive] activities shall be based upon the relative [non-competitive] and [competitive] usage of the investment during the calendar year when [competitive] usage is greatest in comparison to [non-competitive] usage [over a given three year planning period].¹³

Using these principles, we have been able to allocate directly and indirectly \$30 billion in PO's postal service costs: \$17.9 billion to the production of non-competitive products and \$12.1 billion to the production of competitive products. Remaining overhead costs were allocated "using the ratio of all expenses directly assigned or attributed to [non-competitive] and [competitive] activities, and applying that ratio to residual costs."¹⁴ In this manner, PO's \$ 1 billion profit on postal services was accounted for as shown in table 2.

In summary, we conclude that PO may not use any of the \$757 million in profits earned on non-competitive postal services to purchase a private company like Zoom. Profits on non-competitive postal services must be used to reduce rates of non-competitive postal services in the future. PO may use all of the \$ 233 million of the profits earned from postal services last year for the purchase of a private company like Zoom consistent with its duty to maintain postal rates at "just and reasonable" levels.

¹¹*Joint Cost Order*, FCC 86-564 at 1312 (1986)

¹²*Joint Cost Order*, FCC 86-564 at 1319 (1986)

¹³47 CFR 64.901(4)(1998).

¹⁴*Joint Cost Order*, FCC 86-564 at 1318 (1986). See 47 CFR 64.901(b)(3)(iii).

Table 2. Division of PO's postal service profit

	Total \$ million	Non- competitive \$ million	Competitive \$ million
Revenue	50,000	30,000	20,000
Attributable costs	30,000	17,900	12,100
Residual costs	19,010	11,343	7,667
Total Costs	49,010	29,243	19,767
Profit	990	757	233

4. FINANCING FROM CAPITAL GAINS EARNED ON THE SALE OF APPRECIATED PROPERTY

The real estate which PO is considering for sale is popularly known as "Camden Yards." It consists of a large parcel of land located in the business district of a major city. On this property, PO had constructed a large warehouse and terminal for postal operations. A major league baseball is proposing to construct a stadium on the property, retaining the warehouse for offices and shops. The fair market value of Camden Yards is estimated to be \$ 30 million, consisting of \$ 15 million for the land and \$ 15 million for the building. The land was purchased in 1940 for \$ 1 million. The cost of the original building, and various additions and renovations was \$ 10 million, of which \$ 6 million had been charged to depreciation. A year ago, PO stopped using Camden Yards as a postal facility when it consolidated regional operations in a larger, more economical facility located outside the business district.¹⁵

In analyzing the proposed sale of Camden Yards, we are guided by the principles of *Democratic Central Committee v. Washington Metropolitan Area Transit Corporation*, 485 F.2d 786 (D.C. Cir 1973), *cert. denied*, 415 U.S. 935 (1974). As summarized in a recent case, the approach of *Democratic Central Committee* is:

As a general rule, utility service ratepayers "pay for service" and thus "do not acquire any interest, legal or equitable, in the property . . . of the company. Property paid for out of moneys received for service belongs to the company."

¹⁵Deutsche Post, the German post office, has purchased banking interests, foreign parcel companies, a quarter interest in a leading international express company, a major international freight forwarder, and leading private mail forwarding companies in the United States. Deutsche Post's goal is "to secure a strong position in the global logistics market." Deutsche Post, Annual Report 1997, page 49. In response to concerns over the source of funds used to make these purchases, the European Commission has merely noted, for example, "As regards the acquisition of the shares in DHL, Deutsche Post submits that the purchase is being undertaken at a market price . . . so that other potential purchasers have not been excluded from the same possibility to undertake the transaction, and that the acquisition is being financed by the sale of real estate which was the capital endowment for Deutsche Post when it was made into a company." European Commission, Case No IV/M.1168 -DHL / Deutsche Post (1998) at paragraph 31.

However, we have held that *neither ratepayers nor the company (and thus its shareholders) are necessarily entitled to increases in the value of assets employed in the utility's operations. . . . Rather, such increases are to be allocated under a two-step test in which the court first asks which party "bears the risk of loss" on the assets. . . . The party that bore the risk of loss is the party entitled to the capital gains on the assets. . . . Only if it is difficult to determine who bore the risk of loss will "the second principle come [] into play, namely, 'that those who bear the financial burden of particular utility activity should also reap the benefits resulting therefrom.'*"¹⁶

In *Democratic Central Committee*, a local bus company had transferred property consisting of a building and land from operating to non-operating status and then sold the property at a substantial profit. Ratepayers asked the public utilities commission to use the capital gains from the sale to reduce future rate increases. The commission agreed with ratepayers with the respect to the increase in the value of the building because the cost of the building had been offset by depreciation which had been included in periodic rate increases. The commission declined the ratepayers' request with respect to appreciation in the value of the land. On review, the court agreed with the commission in respect to the capital gains on depreciable assets but reversed and ruled for the ratepayers in respect to the capital gains on the value of the land. The court held that the ratepayers bore the burden of loss:

Ratepayers bear the expense of depreciation, including obsolescence and depletion, on operating utility assets through expense allowances to the utilities they patronize. . . . *This entitlement extends, not only to reductions in investment attributable to physical wear and tear (ordinary depreciation) but also to those occasioned by functional deterioration (obsolescence) and by exhaustion (depletion).* Recoupment of investment, particularly where the reduction is gradual, is usually accomplished by annual or other periodic allowances, commonly referred to as depreciation expenses. Recoupment may, however, be effected by a single charge, or by amortization of the investment loss against the ratepayers, as is more frequently done in instances of obsolescence and resulting abandonment of still, serviceable assets. In all cases, the expense levied against ratepayers is the difference between the original cost of the asset and its salvage value, estimated or actual. . . .

*In situations where consumers have shouldered these burdens on an asset which produces a gain, the equities clearly preponderate in their favor. . . . Investors who are afforded the opportunity of a fair return on a secure investment in utility assets are hardly in position to complain that they do not receive their just due from the traveling public. On the other hand, it is eminently just that consumers, whose payments for service reimburse investors for the ravages of wear and waste occurring in service, should benefit in instances where gain eventuates—to the full extent of the gain.*¹⁷

Since the investors did not bear the financial burden of holding the property, even

¹⁶*Illinois Public Telecommunications Association v. Federal Communications Commission*, 117 F.2d 555, 569 (D.C. Cir. 1997) (cites omitted).

¹⁷485 F.2d at 808-11 (footnotes omitted).

the burden that would result from obsolescence if the property became unusable for its purposes, the court reasoned that the ratepayers, rather than the investors, should benefit from the appreciation in the value of the land.

Applying the principles of *Democratic Central Committee* to the present case, we begin by noting PO provided no substantial competitive postal services at the time Camden Yards was purchased and its major buildings constructed. Funds used to pay for Camden Yards were earned from non-competitive postal services. Since rates for non-competitive products were at all times set so as to allow PO to “break even” regardless of losses on the sale of land (or anything else), revenues from non-competitive postal services were, in effect, equivalent to taxes. The “investors,” i.e., the Government, bore no significant risk. Moreover, none of the funds “invested” in PO by the Government were subject to “loss” in same sense that a private investor’s money may be lost, since the Government can recover losses through additional taxes. Under these circumstances, the equitable principles of *Democratic Central Committee* compel the conclusion that all of the capital gains PO earns on the sale of Camden Yards should be used to reduce rates for non-competitive postal services. We hold that PO cannot sell Camden Yards and use the funds to purchase a private company such as Zoom.

A similar conclusion is reached when we consider the implications of our decision in *Non-Postal Services Investigation*. Theoretically, rather than selling Camden Yards itself, PO could transfer Camden Yards to PLC for small consideration, and PLC could sell Camden Yards. In *Non-Postal Services Investigation*, however, we established firm guidelines for the transfer of assets from PO to PLC. That decision required:

all transactions between [PO] and [PLC] be recorded at market price, provided those prices can be determined from prevailing price lists held out to the general public in the normal course of business . . . However, if prices can not be determined from prevailing price lists or tariffs, another [variable] standard would apply. . . . If [PO] purchased the asset or performed the service from [the competitive accounts], the cost recorded . . . would be the lower of the cost to [PLC] less all applicable valuation reserves or the fair market value. *However, if the asset or service were sold by [PO] to [PLC], the sale would be recorded . . . at the higher of the cost less valuation reserves, or estimated fair market value.*¹⁸

Our rule on transfers specifically responded to concerns expressed by the Department of Justice:

If a firm produces nonregulated inputs needed to produce its regulated products, it has an incentive to cross-subsidize by selling itself those inputs at prices higher than the cost of producing them. This would increase the “cost” of the regulated product, but it would also increase the firm’s total revenues because, under cost-based regulation, the regulators would permit a corresponding increase in the price of the regulated product. The carrier,

¹⁸*Joint Cost Order*, FCC 86-564 at 1334 (1986).

therefore, would retain on the nonregulated side the higher profit resulting from the above-cost price paid by the regulated firm to its affiliate. *Conversely, if assets or services of a regulated business are sold to a nonregulated affiliate at too low a price, profits on the nonregulated side will increase. The loss to the regulated business will increase the service's revenue requirement and be recovered from ratepayers.*¹⁹

Since PO would be required to receive fair market value if it transferred Camden Yards to PLC, it should recover no less if it sells Camden Yards to a third party. Either way, the money received must be used by PO to reduce the rates of users of non-competitive postal services.

Finally, we note that the outcome might be different in respect to future investments by PO of money earned from competitive postal services if the Government, or PO management, genuinely bear the risk of loss.²⁰ See discussion at paragraph , below.

In sum, we hold that PO may not use any of the capital gains realized from the projected sale of Camden Yards to finance the purchase of a private company like Zoom.

5. FINANCING FROM BORROWED FUNDS

PO proposes to finance the remainder of the purchase of Zoom by means of a loan arranged with commercial banks.²¹

We see no objection to PO pledging the revenues or assets of PLC as collateral for such a loan. Hence, such matters are beyond the jurisdiction of this Commission.

If PO proposes to pledge revenues or assets of PO itself as collateral for such a loan, then our review would be guided by the principles of *Democratic Central Committee*.

If conditions of the loan are such that PO may be obliged to raise rates for *non-competitive* postal services to repay the loan, then it would be the ratepayers, not PO, who bear the burden of the investment. Ratepayers would be burdened regardless of whether PO pledged future revenues from non-competitive postal services or assets purchased with revenue derived from non-competitive services (since, as discussed above, ratepayers have an interest in such assets). Under current law, PO is

¹⁹*Joint Cost Order*, FCC 86-564 at 1335 (1986).

²⁰*See Illinois Public Telecommunications Association v. Federal Communications Commission*, 117 F.2d 555, 569 (D.C. Cir. 1997) (private investors in telecommunications company held to bear the risk of loss when non-competitive rates are set under a price cap regime).

²¹In August 1996, PTT Post, the Dutch post office, purchased TNT, the Australian conglomerate that owned the private portion of the joint venture, TNT Express Worldwide. This acquisition gave PTT Post majority ownership of a major international express company. The European Commission rejected the suggestion that acquisition was made possible by PTT Post's access to monopoly revenues noting that most of the financing was obtained at "market rates" but the Commission did not address the possible use of non-competitive revenues or assets as collateral for the loans obtained. European Commission. Case No IV/M.843 - PTT Post/TNT/GD Express Worldwide (1996) at paragraph 40.

authorized to make investments necessary to the provision of postal services and thus to impose on ratepayers the burden of such investments. We believe, however, that it would be inappropriate to allow PO to encumber ratepayers with burdens arising out of investments undertaken on behalf of PLC. Indeed, a contrary result would leave ratepayers, rather than PO, with the superior claim to any appreciation in the value of a private company like Zoom. Hence, we hold that PO may not pledge either future revenues or assets related to non-competitive postal services as collateral for a loan used to acquire a private company like Zoom.

If conditions of the loan are such that PO may be obliged to raise rates for *competitive* postal services to repay the loan, the balance of equities comes to rest in a different position. In the first instance, PO bears the risk of its own misjudgements in the provision of competitive postal services. PO may lose market share or even be forced to withdraw some services from the market. Postal jobs are on the line. Hence, the relative claims of PO and ratepayers as to the appreciation of investments backed by competitive revenues and assets tend to favor PO. Under these circumstances, PO should be permitted to use revenues and assets related to competitive products to support a loan whose purpose is to raise capital for PLC projects.

On the other hand, there must be a limit to this principle. Consumer groups have rightly pointed out that a complete failure of all competitive products could have the effect of forcing users of *non-competitive* postal services to pay higher rates because competitive postal services would no longer be able to make a contribution to common costs now shared by non-competitive and competitive postal services. Hence, it would be imprudent to allow PO to pledge its competitive revenues and assets to such an extent that the existence of such services might be jeopardized to the detriment of users of non-competitive postal services.

Therefore, we require PO to submit to the Commission for approval the specific terms of any proposed loan that encumbers the revenues and assets related to competitive products. Such loan will be approved if PO can demonstrate that it does not pose an unreasonable or undue hazard to the rates of *non-competitive* postal services.

ACCORDINGLY, IT IS ORDERED THAT (a) Post Office may purchase, in whole or in substantial part, private companies that engage in, in whole or in part, non-postal activities; (b) in financing such purchases, Post Office shall conform to the guidelines and principles set out in the foregoing Report and Final Order; and (c) all complaints, to the extent they are not herein granted, are hereby denied.

M. Publius., *Secretary*