



## Promoting competition in the postal sector

### Introduction

Across the OECD, traditional state-owned and regulated public utility industries have been transformed by reforms which have fundamentally changed the way these industries are regulated. The former reliance on state control and regulation has given way to greater reliance on competition and market forces, which has led to a greater focus on efficiency, innovation and meeting the needs of consumers.

But to date, these reforms have largely bypassed the postal sector. The postal sector in most OECD countries remains dominated by a state-owned vertically-integrated monopoly, largely still protected from the forces of competition.

This monopoly is however being eroded. Electronic communication in all its forms - fax, Internet, electronic mail and electronic bill payment are undermining the core of the postal business. At the same time express carriers are threatening the "higher end" market for fast delivery of documents and small packages. This competition may erode the ability of the postal incumbents to sustain their universal service obligations.

The postal sector is one of the core infrastructure sectors of the economy. Improved efficiency and customer responsiveness in this sector has the potential to stimulate growth, to promote globalisation and to facilitate the rise of e-commerce.

Liberalisation of the postal sector is not simply a matter of removing existing regulatory controls. Reform of this sector needs to be handled thoughtfully and with attention to employment and universal service issues. Specific attention must be paid to introducing new regulations which ensure non-discriminatory access to essential facilities. Initial indications from reforming countries are promising.

This *Policy Brief* is based on the analysis and conclusions of an OECD report entitled *Promoting Competition in the Postal Sector*. This report, based on a roundtable conducted in a working party of the Competition Law and Policy Committee, was published in October 1999. ■

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## What are the challenges facing postal operators today?

Incumbent postal operators in OECD countries face two primary challenges:

- First, meeting the growing competitive threat from electronic communication, on the one hand, and express and parcel carriers, on the other
- Second, internal reform and restructuring to improve efficiency and customer responsiveness and to reduce losses.

The threat from electronic communications is important. With the growth of the quality, speed and penetration of electronic communications systems, telecommunications is an increasingly strong substitute for physical mail, in some cases threatening traditional revenue streams. America's Postmaster General estimates that:

"In the last five years the postal service has lost about 35% of its business-to-business first class mail, or \$6 billion in revenues, to e-mail, tele-conferencing, and faxing. These electronic services, especially e-mail and faxes, are cutting into the service's first-class mail business, which generates 57% of its revenue".

Canada Post has worried that these developments may undermine its ability to maintain universal service:

"Letter mail volumes no longer keep pace with general economic growth, having been eroded by competition from courier services and electronic alternatives such as fax, electronic mail and electronic funds transfer. The dominant users of Canada Post's letter-mail services—banks, utilities, credit card companies and other businesses—are especially likely to adapt to electronic alternatives where it is cost-effective to do so. The situation poses an acute threat to the long-term viability of universal service at affordable, uniform rates".

One study has found that postal incumbents will lose the most in the business-to-business and business-to-residential markets, with total overall losses of 15-30% of revenues.

However, this loss is offset in part due to growth in some categories of mail, particularly parcels, as a result of stimulation of the mail-order industry.

The second important challenge is reform of the postal enterprise itself. In most OECD countries, the incumbent postal operator is a large enterprise, employing a large number of people and usually (but not always) making a sizeable loss. In Italy, for example the losses of the incumbent postal operator amount to 12 per cent of its revenues.

Over the last decade many countries have reformed the structure and governance of their incumbent postal operators, in a process known as enterprise reform or corporatisation. Such reforms have typically lead to substantial improvements in profitability, service quality, productivity and efficiency. The results in New Zealand can be seen in the box below.

### Corporatisation: One of the First Steps To Reform

Corporatisation is the process of converting a government Ministry or department into a corporate entity with a similar structure, governance arrangements, obligations and responsibilities as other private firms. In New Zealand, the corporatisation of New Zealand Post was an important step towards improving the performance of this enterprise. In the decade since corporatisation (1987-1998) the following effects were observed:

- Productivity: 40% fewer staff since 1987 handle 20% more business.
- Profitability: Loss of \$NZ37.9 million 1986/87 changed to a \$NZ47.7 million after-tax profit in 1996/97.
- Prices: Basic letter price at the same nominal level (40 cents) in 1998 as it was in 1987, implying a substantial real price reduction. In addition, the rural delivery fee (an extra charge for rural dwellers) was abolished in 1995. large business customers benefit from volume and pre-sorting discounts.
- Service Quality: Service delivery performance for a basic letter has improved sharply.

Source: New Zealand Ministry of Commerce, *Postal Services in New Zealand*, May 1998.

Those countries for which the postal operator remains a branch of a government ministry include the USA, Japan and Korea, although in all three of these countries there are policy movements in the direction of corporatisation. At the present time only the Netherlands has privatised its incumbent postal operator. ■

## How can competition be introduced into the postal sector?

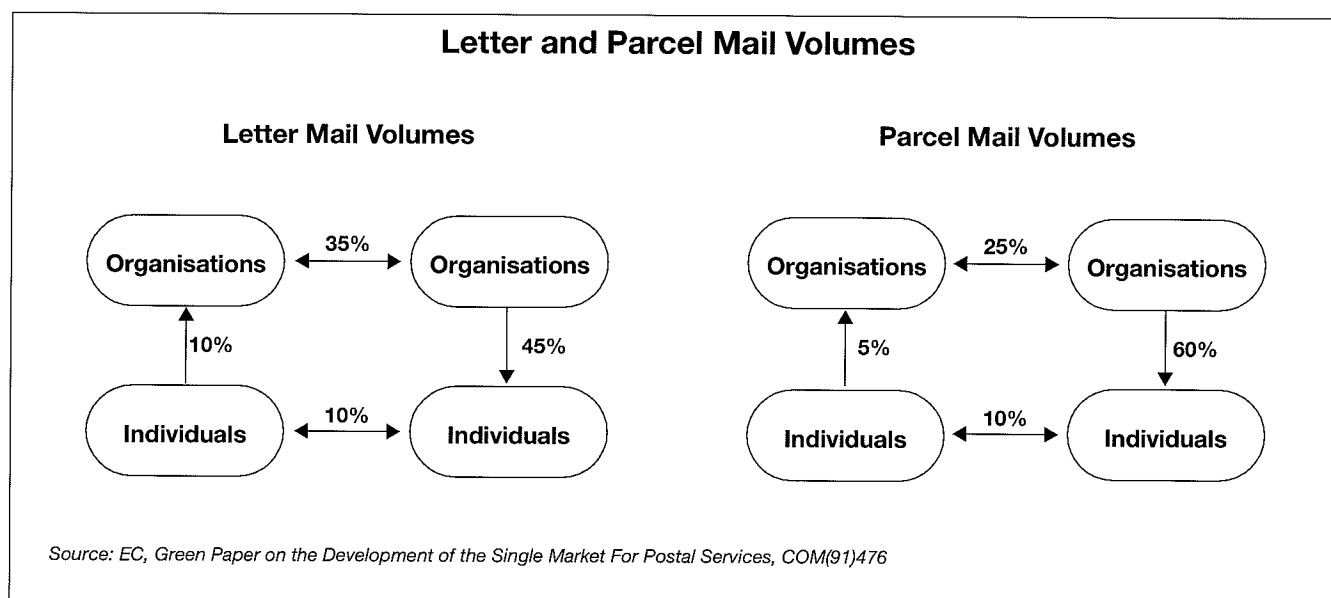
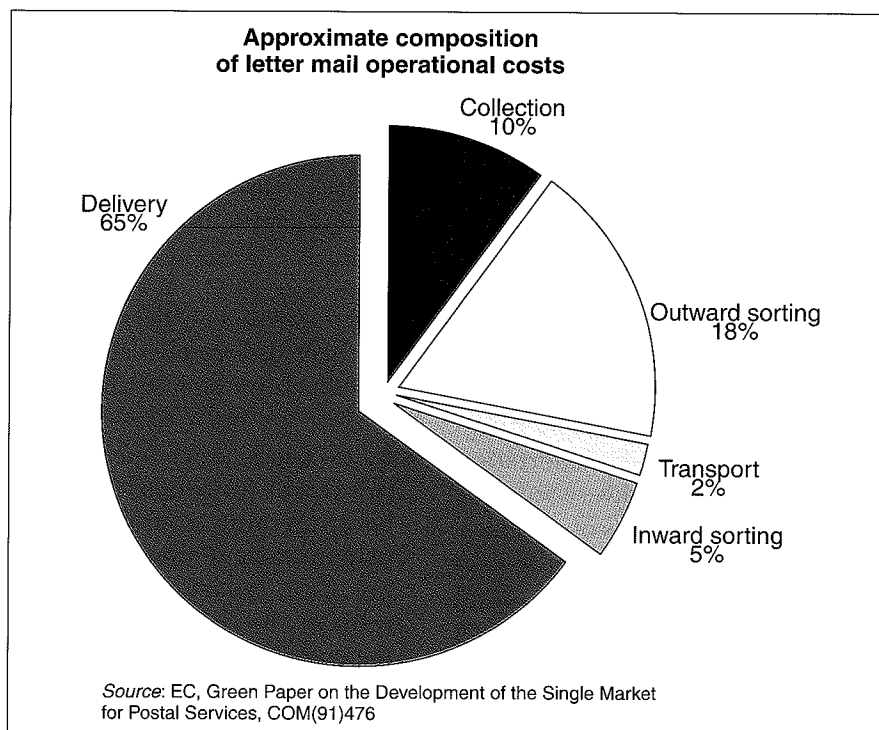
As in any industry, the process of liberalisation begins with an assessment of the markets which can sustain competition and those which cannot. In those markets which can sustain competition, liberalisation is simply a matter of eliminating rules and regulations which restrict competition through controls on entry, pricing, services and so on.

In those markets which cannot sustain competition, the next step is to determine if there are individual "components" or stages in the chain

of production which can sustain competition. Competition can often be introduced into these components by requiring that the incumbent make access available to "vertically related" or "complementary" components which remain

monopolies. This is often assisted by vertical separation of the competitive and the non-competitive components.

In the postal sector, certain services can clearly sustain competition –



particularly express mail and package services. Promoting competition in these sectors is primarily a matter of reducing the size of the monopoly area that is reserved to postal incumbents.

It is less clear that the delivery of ordinary letter mail can sustain competition.

The postal sector can be divided into several complementary activities - collection, sorting, transportation and delivery. Final delivery accounts for the bulk of the costs of mail handling. The economic evidence suggests that there may be a natural monopoly in final delivery, although this depends on a number of factors including mail volumes and frequency of delivery. It is likely that the delivery of mail to businesses and corporations, especially in the centre of large cities is competitive. However, it is unlikely that several companies could compete effectively in the delivery of letters to households, especially in suburban areas (but this will depend on factors specific to each country including the density of delivery points).

Some competition can be introduced into the market for letter mail post by allowing other companies to provide complementary services, such as collection of the mail, sorting, and transportation, handing the mail over to the incumbent only for the final delivery component of the service.

Many postal incumbents already allow a form of competition in this way, by allowing large mail producers to presort and transport their mail in exchange for a discount on the normal mail charges.

Some countries, including Australia and New Zealand, have established an explicit access regime under which entrants are provided with access to the incumbent's delivery services, at prices that represent a discount off the incumbent's retail prices.

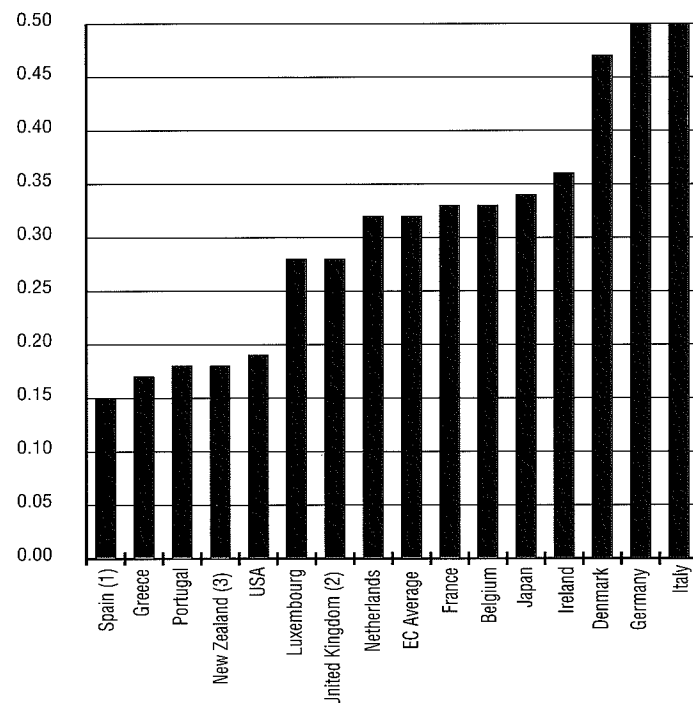
The introduction of effective competition may also require certain other pro-competitive policies such as:

- Rules (such as competition law rules) which prevent the incumbent operator from offering an inappropriate discount to its customers in exchange for an agreement by the customer to place all the customer's mail business with

the incumbent; or any other mechanism for "tying" the sale of competitive mail services with non-competitive mail services.

- Rules which ensure that rival mail delivery firms have non-discriminatory access to letter-boxes and post-office boxes, even when those boxes are located on the premises of the incumbent.
- Centralised arrangements for change-of-address and mail forwarding so that individual mail customers do not have to notify several companies of their whereabouts. ■

1990 Postal tariffs in selected OECD countries



Note: (1) The price indicated is that for a letter sent between two towns (inter-urban), the price for a letter within the same town (intra-urban) is ECU 0.08  
 (2) Price shown for first class letter up to 60g.  
 (3) Price indicated is for the "standard" letter rate. There is faster "Faspost" letter rate equal to ECU 0.37

Source: EC, Green Paper on the Development of the Single Market for Postal Services, COM(91)476

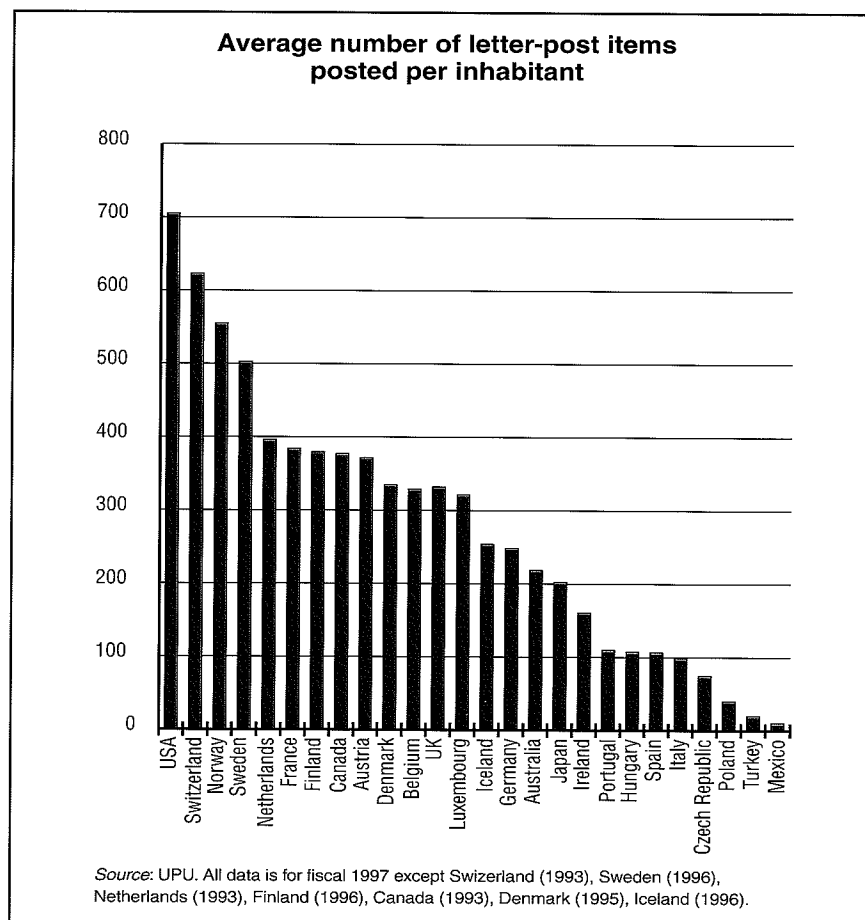
## How should universal service obligations be handled?

Most OECD countries impose requirements on the incumbent postal operator to provide certain services at a certain level of quality, at a price that would not normally be economically justifiable. Examples include requirements to provide a given frequency of deliveries or collections, or to limit the maximum distance to the nearest post office.

Most countries insist on a simple uniform or “geographically-averaged” charge for delivery within the boundaries of the country. In larger, sparsely populated countries this can make uneconomic maintenance of regular deliveries on high cost or low volume routes, including routes in remote or rural areas.

It is often difficult to determine, in advance of liberalisation, which of the imposed requirements are truly non-commercial. Private carriers often adopt a geographically-averaged pricing structure. In the case of New Zealand, under the threat of competition, the incumbent operator is providing services in excess of the regulated minimum. In Sweden, the position was taken that the provision of a ubiquitous service was a competitive advantage for the incumbent operator, rather than a burden.

Let's assume for the moment that some of these obligations are genuinely non-commercial. In most countries the costs of these obligations are financed through internal cross-subsidisation. Such cross-subsidies are likely to be threatened by competition and to distort the nature of that competition. Where there are



cross-subsidies new entrants into the postal sector are likely to focus on the profitable low-cost markets, even when it is more efficient for these markets to be serviced by the incumbent. If the entrants are successful they will take business away from the incumbent in the profitable markets, leaving the incumbent in the unsustainable position of servicing only the unprofitable markets.

Where cross-subsidies may be threatened by competition there are at least two possible solutions.

The first is to tolerate geographic differences in pricing. Allowing, for example, a lower price for deliveries in city centres. Spain has long practiced a two-tier pricing system, with

lower prices for intra-city mail than for mail to other places. In New Zealand, rural mail customers have, in the past, had to pay an extra fee for mail deliveries to the farm gate.

The second possible solution is to fund the cross-subsidies through a mechanism which is neutral to competition. Several countries have or are considering setting up mechanisms for raising the funds for universal service through charges on all postal operators. Where such funds are put in place the subsidies should be made contestable so as to ensure that they are provided efficiently, to minimise the size of the subsidy and to ensure that the incumbent does not receive compensation in excess of the minimum required. ■

## What are the benefits of liberalisation?

A few countries have completely liberalised their postal sector and other countries retain a relatively small reserved area. The liberalising countries reported quality of service improvements, increases in profitability, increases in employment and real reductions in prices.

As of mid-1999 three countries have completely liberalised the postal sector - Finland, Sweden and New Zealand. Of these Sweden and New Zealand have several operators competing in letter delivery. Despite

being liberalised for several years, Finland has had no new entrants, possibly as a result of fears relating to the size of universal service charges on new entrants.

New Zealand has completely abolished its licensing regime in this sector. Australia and the Netherlands have also made significant reductions in the size of the reserved area.

Although fears are often expressed that reform will lead to a loss of employment in this sector, both Australia and the Netherlands report that the level of employment in the postal sector has increased during the reform process, due to a diversi-

fication of the range of services offered by the incumbent.

In Australia and New Zealand the incumbent postal operator is profitable and has reduced real prices consistently over a number of years. New Zealand reported competitors offering significantly lower prices than the incumbent. Although neither New Zealand nor Sweden directly compensate the incumbent for non-commercial obligations, neither country reported problems in maintaining service quality. New Zealand reported that the postal incumbent was experimenting with an enhanced level of service quality in some parts of the country. ■

### The Effects of Liberalisation in New Zealand

In 1987 New Zealand Post had a monopoly over the carriage of letters for \$NZ1.75 or less and weighing less than 500 grams. Successive amendments to the legislation reduced the scope of the reserved area to letters under 200 grams and with a price of less than 80 cents. Finally, with effect from 1 April 1998 the New Zealand government completely removed New Zealand Post's statutory monopoly on the carriage of letters. Any company or individual is now legally able to carry out the business of delivering letters so long as the requirements of the legislation are met. The most important requirement is that all persons carrying lessons must be registered. An application for registration can be turned down only if the person concerned has been convicted of certain crimes. A person is not required to be registered if his or her business relates only to the carriage of items for more than 80 cents.

At the time of deregulation New Zealand Post offered two classes of letter mail – 80 cents for overnight delivery and 40 cents for a delay of 2-3 days.

By the end of December 1998, after only 8 months of operation of the new regime, there were 17 registered operators in New Zealand, most of which were small,

localised businesses. However, Fastway Post (a subsidiary of Fastway Couriers) is establishing a nationwide network of retail outlets. New Zealand Document Exchange Limited (which had long been providing document exchange services) has begun providing regular deliveries in the Central Business Districts of the main centres for 30 cents. National Mail (New Zealand) Limited, a third company, is also planning to roll out a national delivery service. All three of these companies have negotiated access arrangements with New Zealand Post, currently paying between 37-38.2 cents per item.

New Zealand Post has, of course, responded to this competition. It has established its own entirely new retail network, through petrol stations and retail stores, offering a price of 35 cents for a standard letter.

Postal competition in New Zealand is still very new. Already, however, postal competition looks set to develop to a greater extent than any other country in the OECD. Early indications are that deregulation will lead to lower prices and to new products and services.

## What competition issues have arisen in the postal sector?

Typically, competition laws apply to the postal sector although, as is normal in public utility sectors, actions which are specifically authorised by a regulator cannot usually be challenged under competition law rules.

In the postal sector, incumbent operators may, through a variety of actions, such as selective discounting, tying or bundling, act anti-competitively in the competitive sections of the postal market. These practices are equivalent to discounting on the competitive market which may (if the discount is significant enough) amount to anticompetitive cross-subsidisation or predatory pricing. The likelihood of anti-competitive cross-subsidisation is higher in the case of state-owned firms (which may not have strict profit-maximisation objectives).

A firm is said to be engaging in anti-competitive cross-subsidisation if it is charging a price for the competitive service which is less than long-run average incremental cost. In some cases the floor under the prices charged by the incumbent may be set higher by the regulatory authorities, depending on the objectives for competition in the sector.

Many countries (following the EC postal directive) require accounting separation of the competitive and non-competitive activities of the incumbent's postal business as a mechanism for detecting cross-subsidisation. Often this accounting separation relies on a form of "fully distributed cost" accounting (again, following the EC postal directive).

The fully distributed cost approach does not yield economically meaningful results and will not yield a reliable price floor for detecting anti-competitive cross-subsidisation. In many cases the accounting and information gathering procedures of public postal operators are not sufficiently rigorous.

The Director of the Competition Bureau of Canada (amongst others) has, in the past, argued exactly these points:

The Director's "long-standing position [has been] that costing systems can, at best, provide only reasonable approximations of the costs of broad service categories, and are insufficient alone to prevent the cross-subsidisation of competitive services by monopoly service revenues."

Given the difficulties in obtaining reliable cost information, anti-competitive cross-subsidisation may only reliably be prevented through structural or regulatory measures such as privatisation (as in the Netherlands), liberalisation (i.e., elimination of the remaining reserved areas) or horizontal or vertical separation. Horizontal separation involves preventing the incumbent postal operator from providing competitive services such as express or parcel services. Several countries require such competitive services to be provided through an arms-length subsidiary. Vertical separation would involve separating final delivery from the remaining segments of the postal business. Although the final delivery of mail in remote and rural areas is contracted out in some countries, to date no country has systematically sought to separate the delivery activity from the remainder of the postal business. ■

## In summary

The key points of the study on competition in postal sector can be summarised as follows:

- Regulatory restrictions on competition in the postal sector should be eliminated.
- Where there are lingering concerns over the presence of natural monopoly elements in the postal sector, these can be addressed through an access regime.
- Where there are remaining price controls which require services to be provided below cost, the below-cost services should be funded in a competitively neutral manner.
- Remaining competitive advantages and disadvantages of incumbent operators (such as exemptions from taxes) should be eliminated.
- Privatisation or structural separation can eliminate the sources of funds that may be used to cross-subsidise and to anti-competitively undercut an entrant.

The resulting increase in competition can be expected to significantly enhance efficiency, productivity and innovation in the postal sector of OECD countries, contributing to overall competitiveness and economic growth.

## For further information?

More information about the report can be obtained from Darryl Biggar (email: [darryl.biggar@oecd.org](mailto:darryl.biggar@oecd.org), tel: (33-1) 45.24.18.27). ■

## For further reading

- **Promoting competition in postal services**, October 1999,  
Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)
- **International Parcel Delivery**, 1997  
Free on Internet:  
[www.oecd.org/dsti/sti/it/consumer/prod/e\\_97-151.htm](http://www.oecd.org/dsti/sti/it/consumer/prod/e_97-151.htm)

**On regulation and competition issues in other sectors:**

- **Promoting competition in the Natural Gas industry**, 2000,  
Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)
- **Competition and Local Services: Solid Waste Management**, 2000,  
Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)
- **Competition and Regulation in Broadcasting in the Light of Convergence**, 1999,  
Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)
- **Competition and Related Issues in the Insurance Industry**, 1998, Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)
- **Enhancing the Role of Competition in the Regulation of Banks**, 1998,  
Free on Internet:  
[www.oecd.org/daf/clp/Roundtables](http://www.oecd.org/daf/clp/Roundtables)

**On regulatory reform:**

- **The OECD Report on Regulatory Reform, Synthesis**, ISBN 92-64-15556-2 US\$7 pp. 65  
Summary free on Internet:  
[www.oecd.org/subject/regreform/](http://www.oecd.org/subject/regreform/)
- **The OECD Report on Regulatory Reform 2 volumes: Sectoral Studies and Thematic Studies**  
ISBN 92-64-15519-8 US\$47 pp. 700
- **Regulatory Reform in Spain**, 2000,  
ISBN: 92-64-17668-3, US\$58, 312p.
- **Regulatory Reform in Hungary**, 2000,  
ISBN: 92-64-17668-3, US\$58, 312p.
- **Regulatory Reform in Korea**, 2000,  
ISBN: 92-64-17668-3, US\$58, 312p.
- **Regulatory Reform in Mexico**, 1999,  
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