Appendix U

APPENDIX U — The Universal Service Obligation and the Postal Monopoly†

Part 1 — Defining and Measuring the Postal Universal Service Obligation

Introduction

Historically, Congress has provided the Postal Service a legal monopoly over the delivery of letters in order to provide financial support for universal service to all areas of the United States. This universal service obligation, or USO, as summarized in the Postal Reorganization Act of 1970, requires the Postal Service to "provide prompt, reliable, and efficient services to patrons in all areas and…render postal services to all communities" at "fair and equitable" rates. The Act further requires the Postal Service to "receive, transmit, and deliver throughout the United States written and printed matter, parcels and like materials…". The extent of the Postal Service's universal service obligation is quite broad. It must serve "as nearly as practicable the entire population of the United States." Additional requirements specify that the Postal Service must offer a uniform rate for sealed letters.

Other forms of public service obligations arise in different contexts. For example, the Postal Service assumes responsibility for fulfilling the Acts of the Universal Postal Union (see Appendix I). In the context of rate making, one of the statutory criteria consists of consideration of educational, culture, scientific and informational value of the mail. This criterion generally weighs in favor of low rates for socially valued types of publications. By law the Postal Service also fulfills other social policy objectives, ranging from reduced rates for nonprofit mail and non-zoned rates for books, films, and like matter,[1] to specialized labor protections.

The government imposes universal service obligations on a firm or industry when socially desirable services are unlikely to be provided in sufficient quantities or at affordable rates. USOs arise in a number of industries and are funded in a variety of ways: by a direct governmental subsidy, by assessments on providers or customers, or internally with strong contributions by a "reserved area" of products or services somewhat protected from competition.[2] The Postal Service USO is funded internally, through cost averaging and differential markups, with First-Class Mail carrying the largest total share of institutional or overhead costs. The Private Express Statutes grant the Postal Service the exclusive right, with limited exceptions, to carry letters for compensation.[3] These laws, which establish the Postal Service's "reserved area," protect the revenue base that enables the Postal Service to meet its USO. In addition, the network of mailboxes approved by the Postal Service for its use is not available to other services without paying postage.

† This appendix was prepared for the United States Postal Service by Laurits R. Christensen Associates, Inc., an economics consulting firm in Madison, WI, that specializes in regulated industries, including natural gas, electricity, telecommunications, transportation, and postal services.

[1] 39 USC 101(a), (d); 39 USC 3626; 39 USC 3683.

[2] "Reserved area" refers to the products and services over which a postal service has a monopoly.

[3] A discussion of the Private Express Statutes can be found in *"The Postal Service Monopoly"* on page 10 of this appendix.

In recent years, this system of internally funding the postal USO has come under closer scrutiny. Some have questioned whether the cost of maintaining the USO is large enough to warrant the current monopoly restrictions. Others have expressed concern that increased competition in delivery and the expansion of electronic communication may erode the postal monopoly to the point where funding from the reserved area will not be sufficient to cover the USO cost and maintain other social obligations.

One of the difficulties, in addressing these issues, is that while postal obligations are broadly defined by legislation, the USO today permeates the postal system and does not comprise separate services or distinct pieces. In addition to providing service across the United States, the Postal Service “averages” rates across a number of mail pieces with different cost characteristics to provide a uniform rate for letters as required by law as part of the USO. The cost of the USO depends upon the USO definition. A definition that includes an extensive list of obligations will generally be associated with a high cost, while a limited definition will have a lower cost. Finally, even the more commercial of the services offered by the Postal Service are sometimes accorded USO valuation by customers who depend on them, or by their elected representatives. For example, parcel shipments of live animals, or Express Mail service to comparatively remote communities, once established, cannot be curtailed without arousing some controversy.

Universal service obligations have been an issue in a number of regulated industries. Universal service is a key element in the regulation of the telecommunications and electric power industries. As these industries are being restructured and deregulated, important issues have arisen about the maintenance of universal service. Various transportation industries also have universal service as an objective. Prior to the deregulation of the rail and airline industries, the Interstate Commerce Commission and Civil Aeronautics Board established mechanisms to maintain service to small communities. After the industries were deregulated, new legislation was put into place to help maintain service in small communities. The programs developed to address universal service concerns differ across industries. This is due to differences in the economic structure of the industries and differences in regulatory objectives.

In the past few years, a number of countries have begun addressing the postal USO. In particular, formal undertakings in Australia, the European Union, and the United Kingdom have attempted to define the scope of universal service and measure its cost. These efforts have been driven by the objective of introducing competition in the postal industry. Evaluating and costing the USO are important elements in weighing the risks and benefits of allowing greater competition.

While there have been no official undertakings addressing the U.S. Postal Service’s comparatively nonspecific USO, a number of studies have been published in the past few years that attempt to make a start at estimating USO costs. These studies have produced widely varying cost estimates, as well as different policy conclusions. The differences in these studies are largely due to different assumptions about the impact of competition and cream skimming on Postal Service finances, and differences in data availability. Furthermore, these studies focus on mail delivery, ignoring other potential dimensions of universal service and other social obligations of the Postal Service.

This section reviews the universal service obligation in various U.S. industries. It also reviews the formal undertakings to define and measure the cost of the USO in other countries, as well as reviewing the recent literature on Postal Service USO costs.

The conclusion to be drawn from this review is that an accurate cost evaluation of the Postal Service USO would incorporate the following elements. First, there must be a comprehensive and precise definition of the universal service obligation. Second, realistic assumptions must be made about the competitive environment that the Postal Service will face. Third, universal service cost calculations must be derived from data that are much more detailed than those currently available in the Cost and Revenue Analysis or other public data sources. These requirements set a challenging target for universal service cost studies, but without these elements one cannot accurately measure the cost of universal service.

Universal Service in Various U.S. Industries

Telecommunications. Some have suggested that the process of defining and attributing cost to the U.S. Postal Service USO might follow the pattern established for the much more technology-intensive telecommunications sector under the Telecommunications Act of 1996 (the Telecom Act). But there are significant differences between the two industries. The biggest difference arises from the fact that customers are physically connected to the telecommunications network, and customers pay monthly fixed charges for that physical connection. In contrast, there is no physical link between customers and the postal network. At the same time, there is fixed cost in setting up the postal network that parallels the fixed cost associated with the physical telecommunications network, but customers do not pay monthly subscription charges to be "linked" to the network. Instead, postage rates are set high enough to recover the fixed cost. If mail volume declines, rates must be raised, or else the fixed cost will not be covered.[4]

The telecommunications universal service obligation is also different from what is generally considered the postal USO. Universal service in the telecommunications industry has always been based on providing some amount of service to as many households as possible, but not every household has service. The provision of these services at "affordable" rates has been the primary means of achieving the telecommunications universal service goals. Before 1996, telecommunications universal service was thought of as connecting as many households as possible to the network. Since 1996, the USO definition has focused on particular telecommunication "services" that are widely used (e.g. touch-tone service and 911 service). In contrast, the current Postal Service universal service obligation is to deliver virtually all of its services to every address, but the type of delivery service can vary by household; some households have service to the door while others have service to cluster boxes.

The Telecom Act was designed to promote full competition in the local exchange segment of the telecommunications industry. It encourages the entry of "competitive local exchange carriers" into markets currently served by "incumbent local exchange

[4] This discussion focuses on wire-line telephony. The cellular telephone network does not have a physical connection to the customer, but it has substantial fixed costs associated with linking the customer to the network, and the customer pays a fixed monthly subscription charge.

carriers." The Telecom Act recognizes that this increased competition will make it infeasible to finance universal service through a system of internal subsidies, therefore it establishes an explicit funding mechanism for universal service. Furthermore, competitive bidding is encouraged for the provision of universal service. While there have been proposals to restrict the Postal Service monopoly, these proposals do not go as far as the Telecom Act to encourage competition in all sectors of the postal industry, including universal service.

Airlines. Before the Airline Deregulation Act of 1978, the Civil Aeronautics Board maintained universal service by awarding routes to particular carriers. As part of airline deregulation, Congress established the Essential Air Service program to ensure that small communities would retain some level of air service. The U.S. Department of Transportation pays a subsidy, if necessary, to ensure that a specified level of service is provided to eligible communities. The Federal Aviation Administration funds these airline subsidies from general appropriations that amount to approximately $50 million per year. This program is less formally structured than the telecommunications industry's approach to universal service and is not very large in its scope. For the few communities that receive it, the subsidy amounts to approximately $100 per passenger.

The airline industry is an example of an industry that has been deregulated for many years. The current scope of the airline USO is minimal, as is its funding. Unlike the expansive postal USO that requires the Postal Service to deliver to every address, the Essential Air Service program does not mandate service to all communities, and relatively few communities receive subsidized airline service. In addition, the source of future funding for the airline USO is always subject to changing political priorities.[5]

Railroads. U.S. railroads were historically not permitted to abandon freight services to small communities. This changed in 1980 when the Staggers Act substantially reduced railroad regulation. Since then, the federal government has fostered the maintenance of freight service to smaller communities through the Local Rail Freight Assistance Program. Communities may apply for funding for three types of projects: 1) acquisition of lines that have been authorized for abandonment; 2) rehabilitation of low-density lines; and 3) construction of rail facilities with respect to low-density lines. All community proposals must pass a cost-benefit test in order to receive funding. In recent years, funds have not been authorized for this program, so its future appears in doubt.

There are also numerous state and local programs that have subsidized the provision of rail service to communities. These programs are often thought of more as economic development initiatives than universal service programs.

Similar to the Postal Service's obligation to serve all delivery points, railroads were once forced to serve many high-cost and unprofitable areas. This created widespread financial instability in the industry. Since the Staggers Act, railroads have abandoned thousands of miles of unprofitable lines (some of which were eventually taken over by small, regional railroads). These abandoned lines are a visible representation of the scope and cost of the industry's former universal service obligations, which have since been eliminated.

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[5] When the external source of USO funding is the United States government, the availability of funds depends upon a political process. Funds are not always authorized even if legislation is passed that provides for such expenditures. See the discussion of the railroad industry below.

Electric Power. A number of programs in the electric power industry are related to universal service goals. These include programs that provide funding to electric power providers to construct facilities in high-cost, largely rural areas; programs that assist low-income consumers; and programs that assist distribution companies that provide universal service to customers. To the extent rates are averaged, low-cost customers subsidize high-cost customers (although high-cost customers are not necessarily customers who have difficulty paying for service).

Universal service programs that assist low-income consumers are administered at the state level and vary across states. While these programs have existed for a number of years, many states now use these programs in conjunction with industry restructuring. For example, Maryland has established an Electric Universal Service Program authorized by the Maryland General Assembly to assist low-income electric customers with arrearage retirement, bill assistance, and weatherization.

Under electric power industry restructuring, the USO is accomplished through the designation of default electric power suppliers. In general, electric industry reform legislation gives the states' public service commissions the responsibility to determine the methodology for selecting default suppliers. There have been a number of bills before Congress that address competition and universal service in the electric power industry. However, at the current time, a federal bill has not been enacted.

The electric power industry is another traditionally regulated industry that is moving toward a competitive market structure. While there are some programs to fund infrastructure development, the primary focus of universal service programs is the provision of assistance to customers who have difficulty paying their bills. This industry is adopting many options for funding universal service that do not involve maintaining a reserved area. The electric power industry programs also focus on the ability of low-income customers (who are not necessarily the protected high-cost customers) to pay for service. Under the current Postal Service rate structure, the ability to pay is not an issue because there are no explicit network connection fees, and postage fees are a small part of the average household's expenditures.

Postal Universal Service in Australia and Europe

Australia, the European Union, and the United Kingdom have all undertaken formal reviews of their postal USOs in recent years. Generally, these studies have estimated a relatively low level of USO cost. The low estimates are due to a number of factors including narrow definitions of the USO relative to the United States, data limitations, and poor data quality. Because of these limitations and shortcomings, and the fact that postal services are provided under a number of different institutional frameworks, the results of these studies are of limited use in addressing postal USO costs in the United States.

Australia. The Australian Postal Corporation Act requires that Australia Post operate for profit and that its USO be internally funded.[6] The USO embodied in Australia Post's legislative mandate requires that it provide universal letter service with prescribed minimum service standards, reasonable access, and a uniform price.

[6] In Australia, the cost of the USO is generally referred to as the community service obligation.

In 1998, Australia Post released its Customer Service Charter, which outlines its customer service standards. That same year, the National Competition Council conducted a review of postal operations, in order to determine whether any legislative changes were necessary.[7] The Council looked at a number of issues including the specification of the USO and its cost. As part of this process, Australia Post submitted a USO cost estimate of $67 million (Australian), or about 4.2 percent of Australia Post's revenue from letters (and about 2.5 percent of its total mail revenue). While the National Competition Council had concerns about some of the details of the Australia Post study, by not providing alternative estimates of the USO cost, the Council implicitly accepted the results.

In estimating the USO cost, Australia Post had limited data, and had to make a number of assumptions. In particular, it assumed that all delivery points served by the same facility had the same delivery cost, and that upstream costs (i.e., acceptance, transportation, and mail processing costs) did not vary across offices. These assumptions may have led to an understatement of the USO cost, inasmuch as the estimate did not capture the actual cost variation. One should also note that the USO definition is restricted to letters. As such the results may not be projected to a more expansive USO.

European Union. The European Union has undertaken a process of liberalizing postal markets in its member countries. In May of 2000, the European Commission (EC) issued a proposal for the opening of postal services to competition. This proposal, if adopted, would provide for new limits on the regulation of postal services in member countries. One element of the EC proposal is a more restricted reserved area. The EC's discussion of its proposal states that on average for the countries studied the cost of the USO is estimated to be five percent of total revenue. This relatively low cost of universal service is cited as a reason for opening postal services to further competition.

The five percent estimate is derived from a Commission-sponsored study, conducted by National Economic Research Associates (NERA).[8] The Commission retained NERA to identify how postal USOs are defined and provided in European Union (EU) member states, develop a methodology for calculating the USO cost, and develop benchmarks for member countries. The NERA study included a survey of the postal USO for 15 EU countries.[9] NERA found that the USO varied widely across these countries, and decided to focus on five common USO elements:

- Universal delivery;
- Saturday delivery;
- Concessions for press and other printed matter;
- Free delivery of Braille and related materials; and,
- Post office counters.

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[7] "Review of the Australian Postal Corporation Act," February 1998.
[8] Universal Service Obligations in the Postal Sector in the European Union, Final Report for EC DG XIII, November 1998.
[9] The EU countries were: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, and the United Kingdom.

Not all countries in the study possessed the necessary data to measure the USO cost for each of these five factors. Even in cases where a factor was part of a particular country's definition of the USO, data were not always available to measure the cost. In its final analysis, NERA focused its empirical work only on the cost of universal delivery. Six of the EU countries did not possess the data needed to determine the cost of this one element of universal service. For the remaining countries, NERA estimated that the cost of universal delivery ranged between 0.7 percent and 14.3 percent of revenue, with the estimates "clustered around" five percent. NERA recognized that the data used in the analysis were very crude for some countries. In addition, the degree of aggregation of the data likely contributed to the relatively low estimates of USO cost.[10] Finally, the validity of simple, cross-country comparisons is questionable due to differences in the countries' universal service obligations, operating practices, and methods for providing universal service. For example, a USO cost estimate is of little use if the postal administration is not free to abandon or restructure services and pursue strictly commercial ends outside the bounds of the USO as defined for the estimate. The USO dimension actually analyzed by NERA was only one element of what potentially would be the U.S. Postal Service USO. For all of these reasons, the NERA estimates are of very limited use in understanding the cost of the Postal Service USO in the United States.

United Kingdom. In June of 2001, Postcomm, the new regulator of postal services in the U.K., issued a discussion document to assess whether the universal service obligation compels Consignia[11] to provide loss-making services that it might otherwise avoid if it were not required to provide the universal service.[12] Postcomm commissioned Andersen Consulting to update estimates generated by NERA for the U.K. in its EU study. Andersen used data for the period 1999/2000 to focus on the delivery of letter mail. Andersen found that the total cost across all routes where revenue does not cover long-run marginal cost is £81 million. This result was substantially above the NERA estimate of £22.6 million. The difference between these two estimates can largely be explained by the fact that NERA aggregated data by delivery office before estimating the USO cost. By ignoring cost differences within offices, the NERA estimate had a downward bias. Andersen conducted a sensitivity analysis and found that the cost estimate could be as high as £539 million, but it concluded that the USO cost was unlikely to be greater than £81 million. Andersen's reason for concluding that the £81 million figure represented an upper bound was that it included the entire range of postal letter products, some of which are provided at service standards higher than those required under the USO.

To summarize, the Australian and European USO studies employ relatively narrow definitions of the USO. The definitions are restricted to the delivery of mail and, in the case of Australian and the U.K. studies, only focus on letter delivery. When one compares the results for different countries, one concludes that differences in institutions, public expectations, geography, and operational practices can lead to vastly different USO cost estimates. For this reason, the empirical results from these countries should not be used as a benchmark for measuring the U.S. Postal Service USO cost.

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[10] See the following discussion of U.K. USO study for a discussion of the relationship between data aggregation and the size of the cost estimate.
[11] Consignia is the new name for the U.K. Post Office.
[12] "An Assessment of the Costs and Benefits of Consignia's Current Universal Service Provision," A Discussion Document, June 2001.

Studies of the U.S. Postal Service

In recent years, there have been a number of studies of the U.S. Postal Service. Below is a representative list of such studies.

Bradley and Colvin, “Measuring the Cost of Universal Service for Posts,” *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 29-46.

Bradley and Colvin, “The Role of the Monopoly Product in the Cost of Universal Service,” *Future Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2001, pp. 163-180.

Cohen, Ferguson, and Xenakis, “Rural Delivery and the Universal Service Obligation: A Quantitative Investigation,” in *Regulation and Nature of Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1993, pp. 161-176.

Cohen, Ferguson, Waller, and Xenakis, “An Analysis of the Potential for Cream Skimming in the United States Residential Delivery Market,” *Emerging Competition in Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1999, pp. 141-158.

Cohen, Ferguson, Waller, and Xenakis, “Universal Service Without a Monopoly,” *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 69-88.

Cohen, Pace, Robinson, Scarfiglieri, Scocchera, Comandini, Waller and Xenakis, “A Comparison of the Burden of Universal Service in Italy and the United States,” presented at the ninth Conference on Postal and Delivery Economics, Sorrento, Italy, June 6-9 2001.

Haldi and Merewitz, “Cost and Returns from Delivery to Sparsely Settled Rural Areas,” *Managing Change in the Postal and Delivery Industries*, Crew and Kleindorfer (eds.), Kluwer, 1997, pp. 237-257.

Kolin and Smith, “Mail Goes Where the Money Is: A Study of Rural Mail Delivery in the U.S.,” *Emerging Competition in Postal and Delivery Services*, Crew and Kleindorfer (eds.), Kluwer, 1999, pp. 159-180.

Kolin, “Worksharing, Residential Delivery, and the Future of the USO,” *Current Directions in Postal Reform*, Crew and Kleindorfer (eds.), Kluwer, 2000, pp. 89-106.

The nine studies all address one or more of the following questions:

- What products and services are provided by the Postal Service at a loss (i.e., have revenues that are insufficient to cover their costs)?
- What is the total revenue shortfall incurred for all products and services whose revenues fail to cover costs?
- What products and services are vulnerable to competition in a liberalized postal market?
- What are the financial consequences of mail volumes lost to competitors? Or, what is the value to the Postal Service of restrictions on competition?

The studies provide a limited analysis of the Postal Service USO in that they focus on only one element of a possible universal service definition: delivery.[13] Furthermore, each of these studies assumes that the current frequency of delivery (six days per week) and the current delivery standards (i.e., standards for determining whether delivery is made to the house, to the curb, or to a cluster box) represent the only universal service obligation.[14]

These studies all rely on Postal Service city and rural delivery route data sets, although there are significant differences in the data used and the methods employed. Some of the earlier studies use data sets that have become outdated. The studies also use different levels of detail when conducting the analysis. Even the most carefully specified studies do not have enough detailed cost information to precisely answer the four questions listed above. Typically mail flows are aggregated to conduct an analysis, and mail pieces within each aggregate category are assumed to be identical when the cost calculations are made. This aggregation masks a considerable amount of cost variation between mail flows on different routes, with the estimated cost of universal service possibly understated by a significant amount.[15] Finally, the studies have a wide range of assumptions regarding the estimated impact of competition and cream skimming on Postal Service mail volume. These different assumptions result in different estimates of universal service cost. Competition and cream skimming will focus on mail volumes that make a significant contribution to the Postal Service's overhead cost. If this contribution is lost, then the Postal Service must cover its overhead cost with the contribution from remaining volume. In such a scenario, fewer routes generate enough revenue to cover their own costs, and maintaining universal delivery service becomes more difficult. By assuming that competition is limited, one can reduce the universal service cost estimate.

Because of these differences, the studies produce a wide range of results. At one end of the spectrum, Cohen, Ferguson, Waller, and Xenakis (1999 and 2000) conclude that the Postal Service would not be vulnerable to significant volume losses if competition were allowed. They also conclude that the delivery USO cost to the Postal Service is relatively minor. At the other end of the spectrum, Bradley and Colvin (2001) conclude that competition targeted at the Postal Service's highest contribution mail plus the Postal Service's requirement to fully maintain the delivery network could lead to losses up to $17.2 billion, potentially undermining universal service if not the viability of the Postal Service.[16] Because the studies use a limited definition of universal service and limited data sets, the range of these estimates does not necessarily bracket the actual USO cost. Using a more comprehensive definition and more detailed data could produce a USO cost estimate that is above this range.

To summarize, the empirical studies of the U.S. Postal Service USO to date have significant shortcomings, including the use of obsolete or inadequate data, unrealistic competitive entry assumptions, and unspecified or incompletely specified USO definitions that do not correspond to the real socio-political expectations and

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[13] The Bradley and Colvin (2000) study is an exception to this generalization inasmuch as it considers both delivery and retail window service.
[14] Haldi and Merewitz (1997) consider the impact of less frequent delivery and use of independent contractors for rural delivery.
[15] It is noteworthy that the studies with the most detailed analysis, such as Bradley and Colvin (2000 and 2001) tend to produce the highest estimates of universal service cost.
[16] Bradley and Colvin (2001) report cost per delivery day. The figure presented here is obtained by multiplying the Bradley and Colvin (2000) USO cost estimate of $9.8 billion by the ratio of cost per delivery day for the scenarios in these two papers ($297.18/$169.26).

constraints on the commercial freedom of the Postal Service as presently constituted. Many dimensions of universal service and its cost have received little or no empirical analysis. These include the collection, processing, and transportation networks; the uniform pricing of First-Class Mail; and service characteristics of delivery other than frequency—e.g., to what extent delivery to PO boxes and/or cluster boxes might meet delivery obligations for addresses that currently have curbside or door delivery. Little attention has been given to other socially derived constraints, including those which prevent optimal pricing or drive significant portions of labor costs.

Conclusion

The U.S. Postal Service provides a wide array of services to the public on a universal basis. Some of these services were mandated as part of the Postal Reform Act of 1970, while others have been taken on by the Postal Service over the years. As competition and electronic diversion have presented new challenges to the Postal Service, the maintenance of these services has become an important question.

Defining and attributing cost to the USO in the postal sector is a challenging exercise, still in its infancy. As the cited studies show, one can arrive at a wide range of estimates for USO costs, depending upon the definition of the USO, data quality, and assumptions about the economic environment that the Postal Service faces. Careful thought should be given to policy objectives in further work on the USO. Empirical studies need data and methodologies that accurately represent the current postal environment and provide the detail necessary for improved understanding in this contentious area.

Part 2 — The Postal Service Monopoly

Introduction

Historically, all postal systems had legal monopolies. The justification for the postal monopoly has been the maintenance of postal universal service, which is vulnerable to selective, cream-skimming competition. In recent years there have been discussions in a number of countries about the costs and benefits of maintaining the postal monopoly. Two countries, Sweden and New Zealand, eliminated the monopoly. In other countries, such as Australia, Germany, the Netherlands, and the United Kingdom, the scope of the monopoly has been reduced by liberalizing the laws on delivery, and reopening consideration of the extent of universal service constraints. Some have suggested the U.S. postal market be liberalized.

Another recent development with significant implications for the postal monopoly is the increased use of the Internet for communication. While e-mail can be thought of as the most recent technology that competes with the Postal Service (following the telephone and facsimile machine) there is concern that electronic messaging may erode mail over which the Postal Service has a monopoly. The substitution of electronic messaging for mail is generally referred to as electronic diversion.

This section reviews the nature of the postal monopoly and reasons for its existence. It also reviews how the postal monopoly is being addressed in other countries.

The Nature of the Postal Monopoly and Reasons for Its Existence

The postal monopoly in the United States includes exclusive rights preserved to the Postal Service to deliver letters. The exclusive rights to deliver letters are commonly called the Private Express Statutes.

The Private Express Statutes are federal civil and criminal laws that, except in special circumstances, prohibit the private delivery of letters for compensation over post routes. These laws are found in Titles 18 and 39 of the United States Code.[17] The Private Express Statutes were originally enacted by Congress in 1792, and similar laws were in force during colonial rule and under the Articles of Confederation. Under the Private Express Statutes, delivery of letters by firms other than the Postal Service is prohibited, unless the letters have affixed to them the amount of postage the Postal Service would charge for delivery. Letters are broadly defined to be messages between parties, although the statutes and regulations list a number of exceptions.[18] Some of these exceptions are newspapers and periodicals; books, catalogs, and telephone directories; financial instruments, when sent between financial institutions; and letters sent within a company when carried by the company's employee. Furthermore, the Private Express Statutes provide exemptions to "extremely urgent letters." A mail piece is presumed to be urgent if the amount paid for private carriage is at least the greater of $3 or twice the applicable postage for First-Class Mail (including Priority Mail).

In addition to the Private Express Statutes, the Postal Service has the exclusive right to use the mailboxes, collection boxes, and post office boxes which it has incorporated into its system. Since 1934 deposits of mailable matter in these boxes to avoid postage has been prohibited in Title 18 of the U.S. Code.[19] Insofar as these restrictions help ensure the security of the mail, they provide substantial benefits to the public. At the same time, the restrictions serve to protect the operational and financial integrity of the system. Under these restrictions, both monopoly material and newspapers, advertising flyers, and other material that does not fall under the Private Express Statues cannot be legally deposited in the mailbox without postage. Other delivery firms are free to establish their own network of boxes, but as a result of the letter monopoly, no one else has the routes to do so on the delivery side, other than portions of the newspaper industry, which does not carry letters. Delivery firms typically leave items at the recipient's doorstep, which may create additional costs or reduce the security or value of service for the materials being sent.[20]

Congress has justified the Private Express Statutes as supporting the basic mission of the Postal Service:

- To bind the nation together through the correspondence of the people;
- To provide services in all communities;
- To establish uniform postage rates; and
- To ensure the safety of the mails.[21]

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[17] The laws are found in title 18 U.S. Code, 1693 through 1699, and title 39 U.S. Code, 601 through 606. Regulations implementing these statutes are found in title 39, Code of Federal Regulations, parts 310 and 320.
[18] The United States Postal Service Publication 542, Understanding the Private Express Statutes, June 1998, provides a more detailed description of the Private Express Statutes.
[19] Title 18, U.S. Code, 1702, 1705, 1708, and 1725.
[20] For example, some municipalities have ordinances that require delivery services to collect items left on the doorstep after 24 hours.
[21] See Understanding the Private Express Statutes, p. 2.

This mission as stated in Title 39 of the U.S. Code may be thought to set out the core elements of the Postal Service's universal service obligation (As discussed in the Universal Service Obligation section of this Appendix, the scope of the Postal Service's universal service obligation at any particular time is a policy matter subject to discussion, interpretation, and some discretion).

The rationale behind the Private Express Statutes is that the exclusive right to provide letter mail delivery services granted to the Postal Service creates a revenue base with which the system is maintained and the universal service obligation is funded. While the Postal Service sets rates to break even overall, services will generate net revenue ("contribution") in some areas and generate net losses in others. Under the umbrella of the Private Express Statutes, the Postal Service is able to support the USO through a degree of "cross-subsidizing" on a geographic basis, as various routes are more or less expensive to serve than others. Without the Private Express Statutes, competitors not facing universal service requirements would have an incentive to undercut the Postal Service to attract "profitable" (contribution producing) mail, thereby taking away the revenue that the Postal Service relies on to keep rates low in the high cost areas.

The Private Express Statutes primarily provide protection for First-Class Mail, Standard Mail, and a significant portion of Priority Mail.[22] While there is no precise line that distinguishes protected volumes from unprotected volumes, there have been efforts to estimate how much Postal Service volume is covered by the Private Express Statutes. In 1998, Price Waterhouse conducted a study for the Postal Service that estimated about 90 percent of domestic volume and about 80 percent of revenue was protected by the Private Express Statutes.[23] Within the protected area, First-Class Mail and Priority Mail generate the greatest financial contribution to Postal Service overhead costs (i.e., the difference between revenue generated by these services and their attributable cost is greatest).

Over the years, various parties have reviewed the need for the Private Express Statutes. In 1973, pursuant to Section 7 of the Postal Reorganization Act,[24] the Postal Service Board of Governors presented a report to the President of the United States and the U.S. Congress. In that report, the Board concluded that the Private Express Statutes were essential to maintaining universal service and that no changes should be made to existing law. At the same time, the Board recommended that the regulations and administrative practices be changed in order to provide clearer guidelines to the public and to adopt certain suspensions, or exceptions.

In 1998, the General Accounting Office (GAO) released a report on the issues relevant to changing the Private Express Statutes.[25] That report surveyed potential competition and found that it had increased since 1971. This included the growth of private parcel delivery, as well as the development of the "expedited delivery" market. Furthermore, the report identified electronic communication as a competitive threat to the Postal Service. The report also addressed the potential losses from liberalizing the Private

[22] Even within these subclasses, there are mail items that already face competition from close substitutes. For example, Standard Enhanced Carrier Route Mail faces competition from newspapers and neighborhood shoppers in the market for advertising information.

[23] Price Waterhouse, Volume and Revenue at Risk: 1996 & 1997 Postal Service Volumes and Revenues Not Covered by the Letter Monopoly, 1998.

[24] United States Postal Service, The Private Express Statutes and Their Administration, A Report by the Board of Governors to the President and the Congress, Pursuant to Section 7 of the Postal Reorganization Act, June 29, 1973.

[25] United States General Accounting Office, Postal Service Reform: Issues Relevant to Changing Restrictions on Private Letter Delivery, Report to the Ranking Minority Member, Subcommittee on Post Office and Civil Service, Committee on Governmental Affairs, U.S. Senate, September 1996.

Express Statutes. The GAO developed a simulation model based on 1995 rate case evidence to assess the impact on the price of a First-Class Mail stamp under various volume loss scenarios. These lost-volume scenarios varied between five percent and 25 percent of total First-Class Mail volume. The model predicted fairly modest changes in postal rates, as the worst-case scenario led to only a ten percent increase in the stamp price.

The Postal Service's reply to this GAO report pointed out that moving from a monopoly environment to a nonmonopoly environment represents a significant change in the postal market and that conventional models of Postal Service cost and revenue would be inappropriate in such scenarios. In particular, customer responsiveness to price changes ("price elasticities") and the Postal Service cost structure would change. The Postal Service conducted alternative simulations, using a model that it felt contained more realistic assumptions, and it concluded that a 25 percent loss in First-Class Mail volume translated to a 20 percent increase in the First-Class stamp price, and when volume losses spread to Priority and Standard mail, the First-Class stamp price increased 54 percent.[26]

The Postal Monopoly in Other Countries

In recent years, a number of other countries have reviewed the status of the postal monopoly. In many instances, these countries have liberalized their restriction on mail delivery. In this liberalized environment, the restricted area is determined by a weight or price limit. Mail that falls within the limits can only be delivered by the postal administration. Mail outside the limit is open to competition. Often this liberalization is part of a contract between the government and the postal service, in which the universal service obligation is specified and limited along with the degree of postal monopoly. This section discusses some of the changes that have been made in various countries.

Australia. The 1995 Australian Postal Corporation Act explicitly set universal service obligations and the restricted area. The universal service obligation includes: service for domestic and international letters; single uniform rates within Australia for standard letters; service that is reasonably accessible to all Australians; and performance standards for posting boxes, delivery timetables, on-time delivery, retail access, delivery frequency, price, and complaints. The restricted area was set at 8.8 ounces and four times the price of a standard letter ($0.92).[27] In 1998, the government announced a postal reform package that would reduce the restricted area to 1.8 ounces and the price of a standard letter ($0.23), without a reduction in the USO. Legislation was not enacted, and in March 2001 the package was withdrawn.

Germany. The Postal Act of December 22, 1997, set up a license system for delivery and universal service. Delivery of letters under 2.2 pounds is subject to regulation. Through 2007, Deutsche Post has an exclusive license to deliver items weighing no

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[26] Also relevant to the discussion are the various cost studies cited in the Postal Service Universal Service Obligation section of this Appendix.

[27] Except in the United States, reserved area weight limits are specified using the metric system. This appendix reports the weight limits using the English weight equivalents. Price limits have been converted from local currencies to U.S. dollars [using exchange rates as of February 5, 2002].

more than seven ounces and costing less than $2.45. The remaining letter mail can be delivered by private carriers, if those carriers secure licenses from the regulatory authority. The universal service requirements include the delivery of letter items up to 4.4 pounds, parcels up to 44.1 pounds, and newspapers and magazines. The requirements also include standards for locations of post offices and collection boxes, as well as delivery times. To date the Deutsche Post monopoly has been large enough to fund the universal service obligation without additional subsidies. The monopoly is expected to expire in the future, at which time potential entrants will be able to bid on licenses for all letters weighing less than 2.2 pounds. While the intent of the legislation is to have the cost of universal service absorbed by the carriers, provisions are made for external funding, as needed.

The Netherlands. In October of 1999, the government substantially amended its Postal Act, and the changes came into force in June of 2000. Under the amended act, TPG is granted a monopoly for domestic letters weighing no more than 3.5 ounces, unless the price is more than three times the tariff for the first weight step. Mail sent to other countries is not included in the monopoly. The universal service obligation includes domestic letters and addressed printed matter up to 4.4 pounds, and parcels up to 22 pounds (with size restrictions). All international mail falls within the universal service obligation.

Both the monopoly and the universal service obligation are narrower than what was in force before June of 2000. Prior to June of 2000, the monopoly included all domestic and international mail up to 17.6 ounces. The universal service obligation included all mail up to 44 pounds.

New Zealand. The Postal Services Act of 1998 removed the statutory monopoly on the delivery of letters. Prior to the act, the monopoly was extended to letters weighing less than 7.1 ounces. With the monopoly removed, any licensed firm may deliver mail. During 1998, New Zealand Post signed a Deed of Understanding with the New Zealand government. This Deed sets out standards with regard to frequency of delivery, number of post offices, and open access to the mail stream, and sets a price ceiling for standard mail. The delivery frequency standards require 95 percent of the delivery points to have six day per week delivery, 99.88 percent of the delivery points to have either five day or six day per week delivery, and the remaining delivery points to have between one and four deliveries per week.

Sweden. In 1993, Sweden became the first country to eliminate the letter monopoly. A universal service obligation was still imposed on Posten AB, however, and through a contract with the Swedish government, it was required to fund the USO through its profits. The USO currently includes: mail service for items under 44.1 pounds; reasonable and cost-based rates, five-day delivery and retail service, and service standards for overnight mail.

In May of 2001, the National Post and Telecom Agency reviewed the status of the liberalized postal market. It found that while there had been increases in competition since 1993, Posten AB still held 95 percent of the market for letters.

United Kingdom. The Postal Services Act of 2000 (“the Act”) sets out a system of licenses for mail weighing less than 12.3 ounces or costing less than $1.42. The Act also provides definitions and standards for universal postal service. In April of 2001 Postcomm (the regulator) granted a license to Consignia for letter delivery throughout the United Kingdom. As part of the license, Consignia assumes universal service obligations that include daily delivery, delivery of packets up to 44.1 pounds, and delivery service standards.

On January 31, 2002, Postcomm released a proposal to quickly open the U.K. postal market to competition. Under the proposal, beginning in April 2002, mailers sending more than 4,000 pieces in a mailing could use private carriers for delivery. Furthermore, mail consolidators would be able to compete on upstream operations (collection, processing, etc.) by taking advantage of Consignia's worksharing discounts. This would immediately expose about 30 percent of Consignia's domestic letter revenue to competition. By April of 2004, an additional 30 percent of Consignia's revenue stream would be open to competition, with consolidators allowed entry into delivery. By April of 2006, Consignia would lose its monopoly. With this liberalization, Consignia would also be given more commercial flexibility in terms of how it provides universal service. In the long run, an explicit subsidy mechanism for universal service would be considered, if it were necessary. The proposal is currently undergoing review and comment by the public.

Conclusion

Two points should be highlighted. First, some, but not all, countries have moved to reduce the restricted area and to contract for universal service. Canada is a notable example of a country that has not gone down this road. Second, much of the activity in Germany, The Netherlands, Sweden, and the United Kingdom can be seen as either stimulating or responding to efforts by the European Union to harmonize postal services across member countries and encourage greater competition in the provision of postal services. In March 2002, the European Parliament is due to vote on a plan to increase postal competition in the member countries. Liberalizing the postal market would take place in two steps, beginning in 2003. In the first step, all member countries would be required to open up the market for all mail weighing more than 3.5 ounces or costing more than three times the price of a standard letter. In 2006, the market would be opened for letters weighing more than 1.8 ounces, or costing more than 2.5 times the price of a standard letter. At that time, a review would be initiated that would investigate the feasibility of fully opening up the postal market by 2009.

There are substantial differences in how countries have gone about opening up their postal markets to competition. At one end of the spectrum, Sweden and New Zealand have eliminated the restricted area. These are small countries able to deliver most of their mail across the country in one day. Germany and the United Kingdom have moved in the direction of licensing delivery of restricted area products. The ultimate objective of the licensing system is to open the delivery of restricted mail to competition, with both the government post and private firms bidding for the licenses. While TPG continues to be the monopoly provider in The Netherlands, the scope of the monopoly and the universal service requirements have changed over time. In Australia, there appears to have been little change since 1995. Canada is similar to the United States in that it has not undertaken major efforts to reduce the restricted area.