

**COSTING AND FINANCING OF
UNIVERSAL SERVICE
OBLIGATIONS IN THE POSTAL
SECTOR IN THE EUROPEAN
UNION**

**Final Report for
EC DG XIII**

**Prepared by
NERA**

November 1998
London

**The opinions expressed in this study are those of the authors and do not
necessarily reflect the views of the European Commission.**

© ECSC-EC-EAEC, Brussels-Luxembourg, 1998

Project Team:

John Dodgson

Ian Senior

Professor Saul Estrin

Phillipa Marks

Michael Buckland

Theon van Dijk

José Maria Rodriguez

Laura Altinger

Michael Begg

Professor Jürgen Müller

Professor Vincenzo Visco-Comandini

Planet

n/e/r/a

National Economic Research Associates
Economic Consultants

15 Stratford Place
London W1N 9AF
Tel: 0171 629 6787
Fax: 0171 493 5937

A Marsh & McLennan Company

TABLE OF CONTENTS

EXECUTIVE SUMMARY	i
1. DIRECTIVE 97/67/EC AND THE TERMS OF REFERENCE	1
1.1. Introduction	1
1.2. Directive 97/67/EC	1
1.3. The Nature of USOs in Postal Services	3
1.4. The Terms of Reference	4
1.5. Terminology	5
1.6. Structure of this Report	6
2. REVIEW OF EXISTING USOS IN MEMBER STATES	9
2.1. Introduction	9
2.2. Components of Existing USOs for Letter Mail	12
2.3. Existing USOs for Parcels Traffic	28
2.4. USOs in Regard to the Provision of a National Network of Counters	29
2.5. The Next Step: Measuring the Extra Burdens Imposed by These USOs	31
3. RECOMMENDED USO COSTING METHODOLOGY	33
3.1. NERA's Recommended Methodology	33
3.2. Alternative Definitions of USO Burdens	38
4. ESTIMATING THE COSTS OF THE EXTRA BURDENS IMPOSED BY USOS	43
4.1. Introduction	43
4.2. Burden Imposed by USOs: the Views of Postal Administrations and Ministries	43
4.3. Estimating USO Burdens of Universal Delivery: the NERA Model	43
4.4. Estimating the Costs of Providing Services at Concessionary or Zero Tariffs	48
4.5. Costs of Service Enhancements which Form Part of the USO	49
4.6. Burden of Counters which Form Part of the USO	49
5. THE EXTRA BURDENS IMPOSED BY USOS	61
5.1. Estimates of the Extra Burdens of USOs	61
5.2. Universal Delivery	63
5.3. Saturday Delivery	68
5.4. Concessions for Press and Other Printed Matter	71
5.5. Braille and Related Material	73
5.6. Post Office Counters	73
6. FINANCING USO BURDENS	77
6.1. Introduction	77
6.2. Financing Extra Burdens of Universal Service: the Options	77

6.3.	Criteria for Appropriate Financing Method	79
6.4.	Financing Methods	80
6.5.	Basis for Assessing Contributions to USO Costs	83
6.6.	Conclusions on Financing USO Burdens	85
 APPENDIX A. LESSONS FROM PREVIOUS STUDIES OF USO BURDENS IN POSTS AND TELECOMS		
		87
A.1.	Introduction: the Relevance of Previous Studies	87
A.2.	Postal Services	87
A.3.	Telecommunications Services	90
A.4.	Differences between Posts and Telecoms	94
A.5.	Conclusions: the Lessons from Previous Studies of USOs	96
 APPENDIX B. ESTIMATING THE USO BURDENS OF CONCESSIONARY OR ZERO TARIFFS		
		99
 APPENDIX C. COUNTRY APPENDICES		
		101
C.1.	Austria	103
C.2.	Belgium	111
C.3.	Denmark	119
C.4.	Finland	125
C.5.	France	131
C.6.	Germany	139
C.7.	Greece	147
C.8.	Ireland	153
C.9.	Italy	161
C.10.	Luxembourg	175
C.11.	Netherlands	181
C.12.	Portugal	189
C.13.	Spain	199
C.14.	Sweden	207
C.15.	United Kingdom	215
 APPENDIX D. ESTIMATES OF USO BURDENS FOR POSTAL SERVICES IN ITALY		
		223
D.1.	Introduction	223
D.2.	Institutional Characteristics	223
D.3.	Aspects of the Analysis	224
D.4.	Estimation of USO Burdens in Postal Services and Parcels	226
D.5.	The USO Burden of Rural Post Offices in Deficit	232
D.6.	Conclusions	233
 REFERENCES		235

LIST OF TABLES

Table 2.1	Summary of USOs in Member States, 1998	11
Table 2.2	Letter Mail: Delivery Throughout National Territory	13
Table 2.3	Letter Mail: Uniformity of Tariffs	15
Table 2.4	Letter Mail: Delivery Every Weekday (Monday-Friday)	17
Table 2.5	Letter Mail: Saturday Delivery	19
Table 2.6	Letter Mail: Delivery to Address	21
Table 2.7	Letter Mail: Collection	23
Table 2.8	Letter Mail: Quality of Service	25
Table 2.9	Concessions for Press and/or other Printed Material	27
Table 2.10	Provision of a National Network of Counters	30
Table 5.1	Estimates of Extra Burdens of USOs at 1997 ECU Price Levels	62
Table 5.2	Universal Delivery: Extra Burden as per cent of Turnover	64
Table 5.3	Universal Delivery USO: Extra Burden per unit of National Mail Delivered	65
Table 5.4	Relationship Between USO Extra Burden Estimates on a FDC Basis, and the Extent to which Data are Disaggregated	65
Table 5.5	A Common Set of Cost Proportions and Elasticities	66
Table 5.6	Sensitivity of Burden Estimates to Cost Assumptions	67
Table C.1	Austria - Basic Statistics	103
Table C.2	Cost Proportions for APT	107
Table C.3	Belgium - Basic Statistics	111
Table C.4	Denmark - Basic Statistics	119
Table C.5	Post Denmark's Speed of Delivery Performance, 1997	121
Table C.6	Cost Proportions for Post Denmark	122
Table C.7	Finland - Basic Statistics	126
Table C.8	Cost Proportions for Finland Post	129
Table C.9	Finland - Delivery Costs and Volumes for Different Areas, Addressed Mail, 1997	130
Table C.10	France - Basic Statistics	131
Table C.11	Cost Proportions for La Poste	136
Table C.12	Germany - Basic Statistics	139
Table C.13	Greece - Basic Statistics	147
Table C.14	Cost Proportions for ELTA	151
Table C.15	Ireland - Basic Statistics	153
Table C.16	Cost Proportions for An Post	158
Table C.17	Italy - Basic Statistics	161
Table C.18	Italy - Traffic Break-down in a Typical Unprofitable Counter	167
Table C.19	Poste Italiane's Reimbursement Requests	169
Table C.20	Break-down of Poste Italiane's Request for Contribution to Losses	171
Table C.21	Cost Proportions for Poste Italiane	172
Table C.22	Luxembourg - Basic Statistics	175
Table C.23	Cost Estimates of Delivering of Newspapers and ASBL Printed Material for EPT	179
Table C.24	Luxembourg - Breakdown of Deliveries, 1997	180
Table C.25	Netherlands - Basic Statistics	181
Table C.26	TPG's Quality Performance	183
Table C.27	TPG's Counter Network	184
Table C.28	TPG's Development of Wage Costs Index and Tariffs	185
Table C.29	Portugal - Basic Statistics	189
Table C.30	Targets for Delivery Time by CTT Correios, 1998	192
Table C.31	Spain - Basic Statistics	199
Table C.32	Spain - Postal Items Delivered within the Target Delivery Time (percentage), 1996	204
Table C.33	Spain - Quality Control of Ordinary Letters by the General Secretary of Communications	204

Table C.34	Sweden - Basic Statistics	207
Table C.35	Sweden Post's Service Obligations	210
Table C.36	United Kingdom - Basic Data	215
Table C.37	Cost Proportions for Royal Mail and Parcelforce, United Kingdom, 1996/97	220
Table D.1	Poste Italiane's Method for Measuring the Costs of Parcels on Different Traffics	225
Table D.2	Post Italiane's USO Burden Estimates for Letters, Hybrid Mail and Postcards, Fiscal Year 1997	227
Table D.3	Post Italiane's USO Burden Estimates for Invoices, Fiscal Year 1997	228
Table D.4	Post Italiane's Printed Matter Similar to Letters, Fiscal Year 1997	229
Table D.5	Post Italiane's Printed Matter (Newspapers, Periodicals and Other), Fiscal Year 1997	231
Table D.6	Post Italiane's Parcels, Fiscal Year 1997	232
Table D.7	Post Italiane's Unprofitable Counters	233
Table D.8	Post Italiane's Final USO Burden Estimates	233

LIST OF FIGURES

Figure 3.1	The Cost of the Letter Delivery USO	35
Figure 3.2	Cost of the USO with a "Tail" of High Cost Traffics	35
Figure 3.3	Cost of the USO when there are Large Variations in Unit Costs Across the Postal business	36
Figure 4.1	Delivery Cost Index, Country A	52
Figure 4.2	Delivery Cost Index, Country B	53
Figure 4.3	Delivery Cost Index, Country C	54
Figure 4.4	Fully Distributed Letter Costs, Country A	55
Figure 4.5	Fully Distributed Letter Costs, Country B	56
Figure 4.6	Fully Distributed Letter Costs, Country C	57
Figure 4.7	Net Avoidable Letter Costs, Country A	58
Figure 4.8	Net Avoidable Letter Costs, Country B	59
Figure 4.9	Net Avoidable Letter Costs, Country C	60
Figure B.1	Burdens of Concessionary Tariffs	99
Figure C.1	Delivery Cost Index for Austria	108
Figure C.2	Delivery Cost Index in Finland	130
Figure C.3	Delivery Cost Index, Based on Density of Delivery Area for France	137
Figure C.4	Delivery Cost Index, Based on Mode of Delivery for France	137
Figure C.5	Delivery Cost Index for Greece	152
Figure C.6	Delivery Cost Index for Ireland	159
Figure C.7	Types of Postal Services in Italy	163
Figure C.8	Delivery Cost Index for Portugal	197
Figure C.9	Delivery Cost Index for the UK	221
Figure C.10	Delivery Cost Index for the UK with Delivery Offices Split between Urban and Rural Components	222

ACKNOWLEDGEMENTS

NERA wishes to acknowledge the considerable assistance we have received from all the fifteen national postal administrations and their sponsoring ministries in the Member States in conducting this study. The opinions expressed in this study are those of the authors, and do not necessarily reflect the views of the European Commission.

EXECUTIVE SUMMARY

The opinions expressed in this study are those of the authors, and do not necessarily reflect the views of the European Commission.

Chapter 1 Directive 97/67/EC and the Terms of Reference

1. Directive 97/67/EC deals with the development of the internal market of Community postal services, and the improvement of their quality. The Directive defines the concept of universal service at Community level, and specifies minimum standards for delivery and clearance of mail. The Directive also specifies that USOs may be financed in two main ways, by cross-subsidy from a reserved area, or by payments from a compensation fund administered by an independent body.
2. The present study has identified a number of burdens that USOs can impose in practice. These relate to burdens of:
 - universality of delivery and clearance;
 - concessionary or zero rates for certain types of material, such as material for the blind, or certain types of printed matter, in particular daily newspapers;
 - requirements to provide levels of quality above the profit-maximising level; and
 - unprofitable counter services to meet requirements regarding "contact points" for postal services.
3. The terms of reference of the present study require :
 - identification of how universal service is defined and provided in each member state at present;
 - a review of methodologies available to calculate the cost of the burdens imposed by USOs in postal services;
 - development of a methodology to calculate the extra burdens of USOs in member states;
 - benchmark USO calculations for member states at present, based on existing rather than "best-practice" cost levels; and
 - a review of the advantages and disadvantages of the methods available to fund USO burdens.

Chapter 2 Review of Existing USOs in Member States

4. Existing USOs differ in Member States, and in some Member States they are set at higher levels than defined in the Directive.
5. Delivery of letters and parcels throughout the national territory, and on five days a week (Monday-Friday) forms part of the USO in all Member States. Delivery throughout the national territory is usually required through legislation, though in most countries five day delivery is usually specified in other written form. Mail is collected daily in all countries, but this does not always form part of the formal USO.
6. Letter delivery to the address forms part of the USO in most Member States, and is most normally specified in other written form than legislation. In some countries mail is delivered to roadside boxes in rural or suburban areas, and there are some addresses in a few countries in remote areas that do not receive direct delivery. Parcel delivery to the address forms part of the USO in some countries, but in others parcels must be collected from the nearest post office unless a premium is paid.
7. Uniformity of tariffs forms part of the USO in most Member States, although until the beginning of 1998 there was a non-uniform tariff in practice in Spain. Uniformity of tariffs may be imposed through legislation, through other written form, or through "custom and practice". Most countries give discounts related to cost-sharing activities such as pre-sorting.
8. A major difference between Member States concerns Saturday delivery. Saturday delivery of all mail forms part of the USO in France, Germany, Italy, The Netherlands, and the UK, while Saturday delivery of letters (but not parcels) forms part of the USO in Denmark. In Austria, Belgium and Luxembourg, the postal administration is required to deliver newspapers, but not other mail, on Saturdays. There are no Saturday deliveries in Finland, Greece, Ireland, Portugal, Spain and Sweden.
9. While all administrations are concerned with quality-of-service (QoS), QoS requirements form part of the formal USO only in Belgium, Denmark, France, Germany, Italy, The Netherlands, Portugal and Sweden.
10. Postal administrations are obliged to offer concessionary rates for certain types of press and printed matter in Austria, Belgium, Denmark, France, Greece, Italy, Luxembourg, Portugal and Spain. In some cases, the cost of these non-commercial rates is covered by direct subsidy from the state.
11. The provision of a national network of counters forms part of the formal USO in a few countries, and part of the informal USO in most others. In these, political constraints often limit the ability of the postal administration to close unprofitable offices.

Chapter 3 Recommended USO Costing Methodology

12. On the basis of our understanding of the issues, and our review of previous work on this subject in posts and telecoms, NERA believes that the most appropriate interpretation of the burden of the USO in postal services is that of the losses which arise on those parts of the business which are covered by USOs, but which would not be provided by a commercial organisation.
13. The definition of the extra burden adopted in the study is therefore as follows: "Universal service burdens arise when a postal administration is obliged by government to supply customers or services in circumstances where the overall revenues generated from doing so are less than the costs of supply, taking account of any revenue benefits from providing universal service. Such services would not be supplied at current prices by a commercial organisation if there were no obligation to do so."
14. Previous work in the area has generally adopted a net avoided cost (NAC) methodology in estimating these losses. This approach involves estimating the burden in terms of the increase in net revenue which would follow if the USOs did not have to be met.
15. Application of this approach to the provision of universal delivery requires estimation of the unit costs of serving different types of customer, and evaluation of the extent to which costs will be saved in the long run if these customers are not served in the same way.
16. There have been two other approaches which have been proposed for the estimation of universal service burdens.
17. The approach based on welfare economics proposes that burdens be measured both in terms of financial losses to postal operators and in terms of losses to consumers because they are not charged economically-efficient prices. However, this approach, which is based on economic efficiency arguments, does not take account of the fact that universal service (and the uniform tariffs which often accompany universal service in practice) is usually imposed for reasons of equity.
18. The second approach, presented by some postal administrations at the meeting at the Commission on June 25th, proposes that the burden of USOs be measured by the loss of profits which would be faced by an efficient postal operator in a liberalised market. NERA believes that this approach would provide an estimate of the reduction in the ability of the postal administration to fund its USO burdens, but not an estimate of the total cost of these burdens. It is therefore more appropriate for consideration of how the USO burden should be funded, rather than with the question of the overall size of the burden. We also believe that adoption of this definition in practice would have adverse incentive effects in the postal market.

Chapter 4 Estimating the Costs of the Extra Burdens Imposed by USOs

19. No postal administration, nor any of the sponsoring ministries, were able to supply us with estimates either of the current burdens imposed by universal service obligations, or of estimated future burdens under alternative liberalisation scenarios. However, some studies are apparently under way in a number of Member States. Estimates also exist of costs of different types of concessionary rates, and of the losses of unprofitable counters in some countries.
20. NERA has developed a model to estimate the burden of the cost of universal delivery. This model, which is designed to utilise data in as effective and transparent a manner as possible, considers the unit costs and revenues of different types of mail. The main inputs to the model are:
 - the proportions of total costs accounted for by different types of function (collection, sorting, transport, delivery, overheads);
 - a unit delivery cost function which shows how delivery costs vary across different types of traffic;
 - average revenue per unit of mail handled;
 - average cost per unit of mail handled; and
 - total annual mail volumes covered by the universal service obligation.
21. The model estimates USO burdens on both a fully-distributed cost (FDC) basis, and on a net avoided cost (NAC) basis. For the NAC calculations the model requires estimates of the extent to which different types of cost will be saved when traffics are no longer carried. NERA has used the results from previous econometric studies of postal cost functions to do this.
22. NERA has also developed frameworks to assess:
 - the net financial costs imposed by an obligation to carry certain traffics at zero or concessionary tariffs;
 - the net financial costs imposed by an obligation to provide a level of service quality, such a Saturday delivery, above the commercially-optimum level; and
 - the net losses **on postal business** handled by unprofitable counters.

Chapter 5 The Extra Burdens Imposed by USOs

23. The report presents estimates of the extra burdens of universal service on both a fully-distributed cost (FDC) basis and a net avoided cost (NAC) basis for Austria, Denmark, Finland, France, Greece, Ireland, Portugal and the United Kingdom. In addition, it presents estimates for Italy on a fully-distributed cost basis.
24. On an FDC basis, the estimates of USO delivery burdens represent between 0.7 and 14.3 per cent of the revenue earned from the total traffics carried. However, the estimates cluster around five per cent of these revenues. The average across these Member States of the USO burden per unit of the total mail carried by the postal operator is around 0.02 ECU per item.
25. Estimates of the USO delivery burdens on a NAC basis are much lower, or even zero. While estimates on a NAC basis will inevitably be lower than those on a FDC basis, the low estimates in this study partly reflect the assumptions made about the extent to which overheads really are fixed. They also reflect the fact that, once a national postal network is in operation, the additional costs of serving areas with relatively high delivery costs may be not be as high as might have been supposed in the past.
26. Because of the different degrees of disaggregation of the data available from country to country, it is difficult at this stage to reach conclusions on the relative burdens of universal service in different Member States, other than those differences which are simply related to the overall size of the market in each country.
27. Saturday delivery is part of the USO in nine Member States. However, in some states, postal administrations would be likely to undertake Saturday delivery because competitors in the private parcel and express sector do so. A burden on the postal administration exists only in those country markets in which **both** Saturday delivery is part of the USO **and** the private sector does not provide it. Using this criterion, Saturday delivery is definitely a USO burden only in Germany. On the basis of information provided by other postal administrations, it may be a burden in Belgium, France, Italy and Luxembourg, but the position is unclear.
28. Concessionary rates for newspapers and periodicals and books are required by the USOs of nine Member States. The shortfall in revenue to postal administrations therefore constitutes a burden that is supposed to be made good by publishers and the government. Some postal administrations suggested that the compensation is too low, leaving them with a residual burden.
29. Four postal operators provided us with estimates of the burdens imposed by providing a free service for material for the blind and the partially-sighted. These estimates would suggest that these burdens are likely to be of the order of magnitude of between 0.2 and 0.5 per cent of total letter mail revenue earned in each Member State.

30. The network of post office counters forms part of the USO in 11 Member States. Governments usually pay postal administrations for the governmental work that their counters transact. In addition, post office counters carry out a large number of banking and other financial transactions that are not part of the postal USO. Postal work associated with counters sometimes forms only a minor part of the business. Therefore any estimate of the **postal** burden arising from maintaining uneconomic post offices must be reduced to reflect the share of postal business in the whole. From data supplied, we have been able to make rough estimates of the postal burden of counters only for Greece, Italy, Ireland and Sweden.

Chapter 6 Financing USO Burdens

31. Directive 97/67/EC sets out two main methods for financing postal USO burdens:
- reserving monopoly provision of particular services, and using the profits from these to support the extra burdens imposed by USOs; and
 - setting up a universal service fund (USF) to which postal operators contribute.
32. Funding mechanisms need to satisfy a number of criteria, including:
- objectivity and transparency;
 - equality of national treatment;
 - proportionality;
 - economic efficiency; and
 - practicability.
33. Franchising is an additional option to reduce the burden imposed by USOs. Under franchising, competing operators bid to provide elements of the universal service which the national operator is not prepared to provide commercially. These elements of service have to be packaged in such a way that there is a clearly-specified obligation on the franchisee. The competitive element in the bidding process should reduce (and, in principle, could even eliminate) the cost of the burden that needs to be funded, though care needs to be taken to ensure that there are mechanisms in place to secure an appropriate QoS. A franchising process can also help to identify the true extent and cost of the real USO burdens.
34. We can see no merit in imposing universal service obligations on all postal operators within a liberalised environment. This is primarily because this would involve imposing additional costs on all operators. It would also increase the unit costs of serving unprofitable areas by the incumbent, since the incumbent would be likely to

lose some volume to the other operators who had obligations to serve the whole network.

35. If a Universal Service Fund (USF) were to be established, there would be a need to establish the basis on which postal operators would contribute to the Fund. We suggest that the most appropriate basis would be revenues earned from profitable parts of the business.
36. However, we also believe that there are serious disadvantages with the USF approach. These include:
- the difficulty of identifying the costs of the extra USO burdens that needed to be funded;
 - the need to ensure that the costs of the burdens are based on the costs of efficient operation, rather than on actual costs which might be inflated by inefficient working practices and/or inflated wage and other cost levels; and
 - the danger that USF contributions would form an entry barrier to new competitors.

1. DIRECTIVE 97/67/EC AND THE TERMS OF REFERENCE

1.1. Introduction

This initial chapter introduces Directive 97/67/EC and explains how the present study is intended to contribute to the development of policy in the postal sector by estimating the extra burdens imposed by postal USOs across Member States in the European Union. The chapter will indicate how the study meets the original Terms of Reference, as clarified in the Commission's Note of 23 January.

The opinions expressed in this study are those of the authors, and do not necessarily reflect the views of the European Commission.

1.2. Directive 97/67/EC

Directive 97/67/EC of the European Parliament and of the Council of 15th December 1997 deals with the development of the internal market of Community postal services and the improvement of quality of service.¹ With regard to the USO in postal services, the Directive defines the concept of universal service at Community level, while leaving member states flexibility for its national implementation.

Chapter 2 of the Directive is concerned with the USO. The chapter consists of Articles 2 to 6. Sections 1 to 4 of Article 3 contain the most important provisions with regard to the definition of USOs.

Article 3.1 indicates that member states shall “ensure that users enjoy the right to a universal service involving the permanent provision of a postal service of specified quality at all points in their territory at affordable prices for all users”. This implies universality of service - delivery and collection - though not necessarily at a uniform tariff. This is for member states to determine, as is the interpretation of “affordability”.

Article 3.2 requires that member states “take steps to ensure that the density of the points of contact and of the access points takes account of the needs of users”, and, to this end, Article 3.3 requires that they “take steps to ensure that the universal service provider(s) guarantee(s) every working day and not less than five days a week, save in circumstances or geographical conditions deemed exceptional by the national regulatory authorities, as a minimum:

- one clearance; and

¹ OJEC L15, 21st January 1998

- one delivery to the home or premises of every natural or legal person, or by way of derogation, under conditions at the discretion of the national regulatory authority, one delivery to appropriate installations”.

This means that there should be at least one collection per working day, and one delivery per working day to all addresses, or if the national regulatory authority permits, to a post box or other location judged appropriate.

Article 3.4 requires that each member state “shall adopt the measures necessary to ensure that the universal service includes the following minimum facilities:

- the clearance, sorting, transport and distribution of postal items up to two kilograms;
- the clearance, sorting, transport and distribution of postal packages up to 10 kilograms;
- services for registered items and insured items.”

The remaining sections of Article 3 relate to:

- the weight of postal packages covered by the USO, which may be increased up to 20 kilograms;
- the obligation to deliver postal packages received from other Member States;
- the minimum and maximum dimensions for the postal items in question which are to be those laid down by the Universal Postal Union; and
- the fact that the Article covers both national and cross-border services.

The Directive lays down minimum standards for the USO, and member states may provide service in excess of these standards. So, for example, they can specify a uniform tariff, or delivery on more than five days per week. Article 12 provides clarification on pricing:

Member States shall take steps to ensure that the tariffs for each of the services forming part of the provision of the universal service comply with the following principles:

- prices must be affordable and must be such that all users have access to the services provided;
- prices must be geared to costs; Member States may decide that a uniform tariff should be applied throughout their national territory;
- the application of a uniform tariff does not exclude the right of the universal service provider(s) to conclude individual agreements on prices with customers;
- tariffs must be transparent and non-discriminatory.”

According to the Directive, the Universal Service Obligations may be financed in two main ways, either by cross-subsidy from profits from a reserved area (Article 7), the traditional method where a postal administration has a monopoly, or by payments from a compensation fund administered by an independent body.

1.3. The Nature of USOs in Postal Services

It is first useful to identify the different forms that universal service obligations can take in postal services, since different types of USO impose different types of burden. Our study has identified a number of types of USO in postal services:

1. Universality of delivery and of collection (clearance²): the requirement that all addresses receive mail, and that mail will be collected from all geographical areas. This is what is most commonly meant by universal service. The Directive requires that universal service be provided at "affordable" prices. In practice, as described more fully in section 2.2.2 below, most Member States impose an obligation to charge a uniform tariff, so that all mail in particular weight (and size) bands must be carried at the same price, wherever it is to be delivered in the domestic market. Indeed, the requirement to charge a uniform tariff is the major reason why universal service imposes a financial burden on postal administrations;
2. Concessionary or zero rates for certain types of material, such as material for the blind, or certain types of printed matter, such as newspapers or other publications. These elements of the USO are sometimes referred to as Community Service Obligations, though this term has also been used in other ways. With the exception of material for the blind, practice in the matter of provision of such services varies considerably between Member States. In some states specific estimates are made of the costs imposed on their postal obligations by such concessionary rates;
3. Requirements imposed by government to provide specific levels of service quality, such as Saturday delivery. These obligations need to be treated with some caution, since the relevant issue is that of whether they would be provided by a commercial organisation in a competitive environment. Any enhancement in service quality will usually involve some increase in costs (such as the costs of delivery on a sixth day of the week), but might also lead to some increase in revenue from increased traffic. A commercial organisation will be concerned to provide the profit-maximising combination of quality and price. The important issue is that of whether obligations

² The Directive refers to clearance rather than collection. Postal literature more commonly uses the word collection to describe the process by which mail is fed into the system, either through collection of mail from public post boxes, or bulk collection from mailers' premises. In this document we will use the terms "collection" and "clearance" interchangeably.

- force postal administrations to provide a level of quality **above** the competitive profit-maximising level. If this is the case, then there will be some loss of profits;³ and
4. USO costs associated with provision of counter services for postal traffic. According to the Commission, the term “points of contact” which is referred to in the Directive, but not defined, includes not only post boxes where mail can be posted, but also post office counters where mail services can be accessed.⁴ It is therefore necessary to consider whether losses are incurred on those parts of post office counter business which form part of the USO. Counters provide a number of postal services, including the sale of stamps and the receipt of parcels and registered items. However, a large volume of other counter transactions relates to banking, money transmission services, and agency services for government such as the payment of benefits and the issue of licences. The costs of these are not to be included in the costs of providing universal postal services, though clearly there are substantial difficulties in allocating costs between the postal and non-postal functions.

1.4. The Terms of Reference

The Terms of Reference for this study set out the scope and requirements of the study. There are four main components. These are:

1. **preliminary work.** This consists of:
 - an indication of how universal service is defined and provided in each Member State;
 - a specification of how the extra costs incurred due to USOs are defined; and
 - a review of the various methodologies available to calculate the costs of USOs in postal services.
2. **the costing of USOs.** This part of the study is to set out and justify the appropriate methodology (or methodologies) to be used to estimate USO costs and, in particular, the extra burdens imposed by USOs. The methodology is to identify the costs of different burdens, and to take account of the benefits of providing universal service. The methodology is to allow recalculation of estimated USO costs when critical parameter values change.

³ Postal administrations are sometimes set minimum service standards such as a minimum percentage of mail delivered by a certain day after posting. However, these may reflect concern that postal monopolies would provide lower standards than would be commercially optimal in a competitive environment. Similar issues arise in regulated industries, where regulators may feel the need to require minimum service standards from regulated natural monopolies. Such obligations to behave in the same way as a commercial organisation in a competitive market should not be regarded as part of the USO.

⁴ Letter of 18 March 1998 from M Alain Jaume to NERA.

3. **benchmark calculations for the cost of USOs.** The study is to provide some benchmark USO cost estimates for Member States. Member states can be grouped if situations are similar, and the estimates may be derived by modelling.
4. **the financing of USOs.** This final part of the study is to consider the methods for funding USOs in the light of the two broad methods identified in the Directive, namely setting up a reserved area and by means of a compensation fund. The study is to consider the theoretical and practical advantages and disadvantages of different approaches, and consider the appropriateness of the different approaches in different circumstances.

With regard to the USO in postal services, the Directive defines the concept of universal service at Community level, while leaving Member States flexibility for its national implementation. The present study is required to estimate the costs of the USO **as they are interpreted by Member States**, rather than as implied by the minimum definition of the USO in the Directive. We are also required to estimate costs and burdens given existing input levels and wage and other payments, ie based on existing levels of operator efficiency.

1.5. Terminology

We next define key terms and concepts used in this report, with brief clarification. The terms are not defined in Directive 97/67/EC.

A **universal service obligation (USO)** is an obligation to provide a given service or quality of service that is legally imposed on a postal operator — normally the incumbent administration — by law, licence or contract. Where operators believe that they have a USO that is not legally defined but results from custom and practice, possibly backed by political pressure, we note this in the relevant sections.

USOs relate only to services provided to the public. Where, for example, an administration employs staff on conditions above the market rate because of their status as (former) civil servants, this does not constitute a service to the public and is therefore excluded from our definition of USO.

The **cost** of a service, whether the service is part of the USO or not, is the expenditure on that service. The **cost of the USO** is the total cost to the postal administration of providing **all** of the services covered by USOs.

The **extra burden of a USO** (also referred to in this report as the **burden of the USO**) is equal to the losses on traffics or activities covered by USOs.

In the Notice 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 (1998)⁵ the term **burden** is not defined but in Article 7 it is used in the context "compensation for financial burdens imposed by the public authorities".⁶ In this context, "burdens" is a general term that could equate to costs in general or to extra costs under USOs in particular. Under our definition, an "(extra) burden" is a particular subset of costs and does not refer to costs in general.

There are two main methods for measuring these extra burdens, the **net avoided cost (NAC) method**, and the **fully-distributed cost (FDC) method**.

The **net avoided cost (NAC) method** is a method for estimating the extra burden of the USO which involves assessing the net costs (ie costs less revenues) which would be avoided if particular traffics or activities were to be withdrawn. A distinction is made between **short-run adjustments** (when capital costs, and even some labour costs, are fixed), and **long-run adjustments** (when all inputs can be varied). In the latter case the method is known as the **long-run net avoided cost (NAC) method**.

The **fully-distributed cost (FDC) method** is a method for estimating the extra burden of the USO which involves calculating the costs of different postal activities by allocating all the costs of providing the existing postal service, including capital costs, across the different activities of the postal operator. These costs are then subtracted from the revenues from the different activities to estimate the extra burden of the USO.

1.6. Structure of this Report

The structure of the rest of this report is as follows:

- Chapter 2 describes the USOs in each Member State as they existed in 1998;
- Chapter 3 discusses alternative methodologies for the estimation of postal USO burdens;
- Chapter 4 describes the framework within which NERA has estimated USO burdens in the present study;
- Chapter 5 presents our estimates of USO burdens in Europe; and
- Chapter 6 discusses alternative approaches to funding USO burdens in a future environment.

⁵ 98/C 39/02. OJ, 6 February 1998, p C39/2 ff.

⁶ *Ibid*, p 39/14.

The report also contains a series of appendices:

- Appendix A provides a survey of previous studies and estimates of USO burdens in the postal sector, and in telecoms;
- Appendix B provides a theoretical framework for assessing the net financial burden of concessions to carry mail, such as newspapers, other printed matter, or Braille, at concessionary or zero rates;
- Appendix C consists of a set of country annexes, one for each Member State, which are based largely on our interview programme. These annexes explain the legal and regulatory framework in each country and describe how we have used the information which was available to estimate extra USO burdens in that Member State; and
- Appendix D provides a detailed study of USO burdens in Italy conducted by NERA with the assistance of Poste Italiane.

2. REVIEW OF EXISTING USOS IN MEMBER STATES

2.1. Introduction

This chapter of the report reviews how postal USOs are currently interpreted in the fifteen different Member States of the European Union. The main source of information for this review are the interviews conducted by NERA with the postal administration and sponsoring ministry and/or regulator in each Member State, together with additional published material.

NERA conducted interviews with all fifteen postal administrations in the European Union, and their sponsoring ministries, in the period between March and the beginning of June 1998. The interviews were based on detailed structured questionnaires which were circulated in advance of our meetings.

The information on postal services and USOs collected as a result of these interviews and from other sources is included in a set of country appendices in Annex C of this Report, from which information for the present chapter has been extracted.

Our review of USOs considers the following main components. These consist of:

Letter mail (mail up to two kgs)

- Whether letter delivery is to take place throughout the national network;
- Whether there must be a uniform tariff wherever in the national territory letters are posted and delivered;
- Whether letters should be delivered every day from Monday to Friday;
- Whether letters must be delivered on Saturday;
- Whether letters must be delivered direct to the delivery address;
- Whether the USO specifies conditions with regard to collection, such as the frequency of collection, or the siting of collection boxes;
- Whether the USO specifies quality of service (QoS) standards for end-to-end letter mail delivery; and
- Whether the USO involves concessionary tariffs for types of traffic such as newspapers, periodicals or other printed material such as books; or for particular users, notably government and other public sector agencies.

Parcels (mail from two to ten kgs)

- Whether parcels delivery is to take place throughout the national network;
- Whether there must be a uniform tariff wherever in the national territory parcels are posted and delivered;
- Whether parcels should be delivered every day from Monday to Friday;
- Whether parcels must be delivered on Saturday;
- Whether parcels must be delivered direct to the delivery address.

Counters

- Whether the USO specifies conditions with regard to the geographical density or total number of post office counter services.

Table 2.1 summarises the situation in 1998 with regard to each of the fifteen Member States. We next consider each of these components of existing USOs in turn.

Table 2.1
Summary of USOs in Member States, 1998

Member State	Letter mail (mail up to two kgs)								Parcels (mail from two to ten kgs)					National network of counters
	Delivery throughout national territory	Uniformity of tariffs	Delivery every weekday (Mon-Fri)	Saturday delivery	Delivery to address	Collection at least daily	Quality of service	Concessions for press etc material	Delivery throughout national territory	Uniformity of tariffs	Delivery every weekday (Mon-Fri)	Saturday delivery	Delivery to address	
Austria	✓	✓	a	ab	✗	✓	a	✓	✓	✓	a	✗	✓	✓
Belgium	✓	✓	✓	b	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓
Denmark	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓
Finland	✓	✓	✓	✗	✓	✗	✗	✗	✓	✗	✓	✗	✗	✗
France	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✗
Germany	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓
Greece	✓	✓	✓	✗	✗	✗	✗	✓	✓	✓	✓	✗	✗	✗
Ireland	✓	✓	✓	✗	✓	✓	✗	✗	✓	✓	✓	✗	✓	✓
Italy	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Luxembourg	✓	✓	✓	b	✓	✓	✗	✓	✓	✓	✓	✗	✓	✗
Netherlands	✓	✓	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓
Portugal	✓	✓	✓	✗	✓	✗	✓	✓	✓	✗	✓	✗	✗	✓
Spain	✓	✗	✓	✗	✓	✓	✗	✓	✓	✗	✓	✗	✗	✓
Sweden	✓	✓	✓	✗	✓	✓	✓	✗	✓	✓	✓	✗	✗	✓
United Kingdom	✓	✓	✓	✓	✓	✓	✗	✗	✓	✓	✓	✗	✓	✓
Additional information in	Table 2.2	Table 2.3	Table 2.4	Table 2.5	Table 2.6	Table 2.7	Table 2.8	Table 2.9						Table 2.10

Notes: a = to be determined; b = newspapers only

Source: Country appendices

Notes

a = to be determined

b = newspapers only

2.2. Components of Existing USOs for Letter Mail

2.2.1. Delivery of letters throughout the national territory

Table 2.1 shows that this is an essential component of USOs in all Member States. Table 2.2 provides additional details. In most Member States this obligation is enshrined in primary legislation. For example, in the UK the 1981 British Telecommunications Act stipulates that The Post Office provide services for the conveyance of letters *throughout the UK*, while in The Netherlands Article 2.2 obliges the postal concession holder to "transport *for every person in the whole country* for a payment letters and other addressed items" (our italics). In Austria the 1997 Postgesetz specifies that there should be permanent provision of postal services at all points in the territory. The nature of this delivery (ie whether it must be direct to the addressee's door) is discussed further in Section 2.2.5 below.

Table 2.2
Letter Mail: Delivery Throughout National Territory

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✓	✓			
Belgium	✓	✓			
Denmark	✓	✓			
Finland	✓	✓			Excludes Aland Islands
France	✓	✓			
Germany	✓	✓			
Greece	✓	✓			
Ireland	✓	✓			
Italy	✓				
Luxembourg	✓		✓		
Netherlands	✓	✓			
Portugal	✓			✓	
Spain	✓	✓			
Sweden	✓	✓			
United Kingdom	✓	✓			

Source: Country appendices

2.2.2. Uniformity of tariffs for letters

By uniformity of tariffs we mean that letters of a certain weight characteristic must be conveyed at the same charge throughout the national territory. Table 2.3 shows that uniformity of tariffs forms part of the USO in most, but not all, Member States.

Table 2.3 also shows that the way in which this component of the USO varies between Member States differs. For example, in Denmark it is included in primary legislation, since the 1995 Bill on Postal Business includes a requirement of uniform tariffs, while in Austria the 1997 Postgesetz specifies a uniform price for universal postal service.

In some other countries the requirement for uniform tariffs is imposed in other written form. In the UK, a Government statement in the House of Commons in 1997 made clear that uniformity of tariffs is part of the USO, since it commits the Government to a nationwide postal service with daily delivery to every address "to a uniform and affordable tariff structure under which it costs the same to post a letter anywhere in the United Kingdom".

In France the uniformity of tariffs is imposed as part of Decree 90-1214. In The Netherlands the requirement to set a uniform tariff is set out in the "General Postal Guidelines", while in Germany uniformity of tariffs is implied by the 1997 Postal Act, or Postgesetz, which specifies that rates must not "create any advantages for individual users in relation to other users of postal services of the same type".

In the liberalised Swedish market the 1994 Postal Services Act specifies that mail should be carried at uniform prices.

In other member States with a uniform tariff, uniformity is not imposed through any written obligation, but as a result of practice. For example, in Ireland there is no written obligation to charge a uniform tariff, but we were informed that any attempt to charge different tariffs for urban and rural traffics would be fiercely opposed at the political level.

While most countries have uniform tariffs for standard letters, there are often discounts for particular types of traffic. Many countries offer discounts for activities such as pre-sorting which reduce the postal administration's own costs. In addition, there may be discounts for certain types of press or other printed matter (see Section 2.2.8 below). The Member State which appears to have the widest range of tariffs for different types of material is Italy. There is no formal obligation on Finland Post to set uniform tariffs, though "post can be sent and received on equal conditions" and payments collected shall be fair and in reasonable proportion to average costs. In practice tariffs are uniform.

Uniform tariffs do not form part of the USO in Spain. Up to January 1998 there were separate tariffs for letters mailed and delivered within a particular urban area, a type of traffic which does not form part of the reserved area in Spain, and for other letters. This differentiation was abandoned in January 1998, but we were informed that this was "for commercial reasons".

Table 2.3
Letter Mail: Uniformity of Tariffs

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✓	✓			But universal service provider may enter special price agreements with customers individually (Postgesetz §10(2))
Belgium	✓		✓		
Denmark	✓		✓		
Finland	✓				No formal obligation, but in practice tariffs are uniform
France	✓		✓		Decree 90-1214
Germany	✓		✓		Implied by rules on price setting in the 1997 Postgesetz
Greece	✓			✓	
Ireland	✓			✓	
Italy	✓				Wide variety of discounts are provided in Italy
Luxembourg	✓			✓	
Netherlands	✓		✓		
Portugal	✓			✓	
Spain	✗				Up to January 1998 there was a non-uniform tariff in operation
Sweden	✓	✓			Postal Services Act 1994
United Kingdom	✓		✓		Government committed to "a uniform and affordable tariff structure"

Source: Country appendices

✓ **Uniform tariff is part of the USO**

✗ **Uniform tariff is not part of the USO**

2.2.3. Delivery of letter mail every weekday (Monday-Friday)

As Table 2.4 shows, delivery of letter mail on every day between Monday and Friday forms part of the USO in every Member State. It is defined in primary legislation in Denmark and Finland, and in written form in most other Member States.

One exception to daily delivery in practice is Greece, where daily delivery is not provided in about one-quarter of rural areas. Rural delivery accounts for one-quarter of total delivery in Greece, and in 1998 mail was delivered four times a week in about 7.5 per cent of the rural areas, three times a week in about 12.5 per cent of rural areas, twice a week in 4.5 per cent of rural areas, and once a week in the remaining 0.5 per cent of rural areas.

In other countries there may not be daily delivery where locations are remote. For example, Finland Post is allowed to take local delivery conditions into account but obtains the agreement of recipients. According to Finland Post, it is very seldom that mail is not delivered every weekday.

In the UK there are two deliveries a day to 89 per cent of addresses but in some smaller Scottish islands daily delivery may not be provided where ferry services do not provide daily services on which mail can be carried.

In Paris there are 3-4 deliveries a day in some parts of the city. These frequencies are not embedded in any formal USO.

The time of completing the first delivery in Member States also results from custom and practice, rather than the USO. Further, it is operationally advantageous to get priority mail out of the delivery office first and to smooth the flow of work by delivering printed and publicity mail later.

Table 2.4
Letter Mail: Delivery Every Weekday (Monday-Friday)

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria					Not in the new law, but expected to be included in a new regulation
Belgium	✓	✓			
Denmark	✓		✓		
Finland	✓	✓			Post office can take local delivery conditions into account
France	✓	✓			Decree 90-1214
Germany	✓		✓		Draft PUDLV
Greece	✓			✓	One-quarter of rural areas do not receive daily delivery
Ireland	✓			✓	
Italy	✓		✓		
Luxembourg	✓		✓		
Netherlands	✓		✓		
Portugal	✓			✓	
Spain	✓		✓		
Sweden	✓		✓		Postal Services Ordinance July 1 st 1998
United Kingdom	✓		✓		Government committed to "daily delivery"

Source: Country appendices

2.2.4. Delivery of letter mail on Saturdays

Table 2.5 shows that Saturday delivery is one case where USO requirements differ between Member States. Saturday delivery of mail is required in Austria (but only for newspapers), Belgium (but only for newspapers), Denmark, France, Germany, Italy, Luxembourg (newspapers only), The Netherlands, and the UK, but not in Finland, Greece, Ireland, Portugal, Spain or Sweden.

Table 2.5
Letter Mail: Saturday Delivery

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria				✓	Saturday delivery is for newspapers only and the extra burden is remunerated by the Federal Government but not specified in law.
Belgium	✓		✓		Saturday delivery is for newspapers only
Denmark	✓	✓			
Finland	✗				
France	✓		✓		Decree 90-1214
Germany	✓		✓		Implied by draft PUDLV
Greece	✗				
Ireland	✗				
Italy	✓		✓		
Luxembourg	✓				Saturday delivery is for newspapers only
Netherlands	✓		✓		
Portugal	✗				CTT may deliver on Saturdays by agreement with major customers
Spain	✗				
Sweden	✗				
United Kingdom	✓			✓	Saturday delivery is not specified in written form

Source: Country appendices

✓ **Service/facility provided as part of the USO**

✗ **No Saturday delivery**

2.2.5. Delivery of letter mail to the address

The conditions under which mail must be delivered can vary in a number of ways. Mail might be delivered direct to the householder's door, that is, to a letter box in the building, where the address consists of a single building. For blocks of apartments mail might be delivered to each individual apartment, to a set of letter boxes for the apartment block, or to the apartment block address as a whole.

Alternatively, mail might be delivered to a roadside box at the end of the addressee's drive: this might be more common in suburban and rural areas, where drives are long, than in urban areas where drives are short.

Finally, mail might be delivered to individual boxes in a local post office, or simply to the post office, and must be collected by the recipient. Postal administrations generally provide such facilities for those who want them.

While delivery to the address forms part of the USO in most Member States, the actual conditions vary. In the UK the Government is committed to delivery to every address in the country, and this is what happens unless the addressee requests otherwise. In Finland delivery to the address requires delivery to a post box at the end of the drive, rather than to the door itself. The Irish Postal and Telecommunications Services Act of 1983 does not require the postal operator to deliver to the addressee's residence or office provided it makes acceptable alternative arrangements. However, when An Post proposed to reduce rural delivery costs in the early 1990s by delivering to boxes at the end of the drive, political opposition forced it to make the move voluntary for the householders, who are able to insist that they receive doorstep delivery.

In rural areas in Austria mail is delivered to roadside boxes, while in outlying areas a small number of addressees have to pick up their mail from the post office. In Luxembourg mail is mainly delivered to roadside boxes. In Denmark, 70 per cent of addresses receive mail to the door, 22 per cent to roadside boxes, 6 per cent to groups of boxes, and two per cent to grouped boxes in post offices.

Table 2.6
Letter Mail: Delivery to Address

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✗				In rural areas roadside boxes. In "outskirts" addresses may have to collect mail from the post office
Belgium	✓	✓			Includes delivery to roadside boxes in some cases
Denmark	✓		✓		Includes delivery to roadside boxes or groups of boxes in some cases
Finland	✓	✓			Applies to a post-box at the end of the drive
France	✓	✓			
Germany	✓		✓		Draft PUDLV
Greece	✗				
Ireland	✓			✓	An Post can make alternative arrangements, but in practice this must be voluntary
Italy	✓		✓		There are some exceptions
Luxembourg	✓		✓		Mainly to roadside boxes
Netherlands	✓		✓		
Portugal	✓		✓		Some exceptions for addresses in remote areas
Spain	✓		✓		There are some exceptions
Sweden	✓			✓	
United Kingdom	✓		✓		Government committed to "every address in the country"

Source: Country appendices

✓ **Service/facility specified as part of the USO**

✗ **Service/facility not always provided**

2.2.6. Letter mail collection

USOs may impose specific conditions on collection, or the postal operator may impose their own rules in order to meet other USOs or for commercial reasons. Table 2.7 shows that USOs apply to collection in Austria, Belgium, Denmark, France, Germany, Ireland, Italy, Luxembourg, The Netherlands, Spain, Sweden and the UK.

In Austria the 1997 Postal Act requires Post und Telekom Austria (PTA) to provide universal service at an appropriate density of points of contact and access points, and by appropriate frequency of clearance, but does not at present define what is appropriate in detail. Under Belgian legislation of 1991 La Poste must provide at least one collection box for each "commune" or section of a commune, and make at least one collection on each day between Monday and Friday.

In Germany, the draft PUDLV specifies that in built-up areas the maximum distance to a collection box should be one kilometre, and these boxes should be cleared at least once a day, including Sundays and holidays if necessary to meet defined end-to-end delivery targets.

Daily collection is not specified in written form in The Netherlands, but because the "General Postal Guidelines" which do form part of the written USO commit TPG to next-day delivery, this implies that they must also collect mail at least once per day. The Guidelines also specify a minimum network of collection boxes in The Netherlands.

In the UK there is no written requirement for daily collections, but the Post Office believe that daily letter collection is a requirement of the USO.

In urban areas, particularly those with many businesses, several collections per day are common. This enables work to be smoothed and prevents boxes being crammed. No administration suggested to NERA that multiple collections were part of their USO.

Table 2.7
Letter Mail: Collection

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✓	✓			Details may be included in a regulation currently in preparation
Belgium	✓	✓			Daily collection specified in 1991 Act
Denmark	✓		✓		At least once per day
Finland	✗				In practice, daily collections Monday to Friday. Sunday collections in some big cities
France	✓		✓		Decree 90-1214: daily collection
Germany	✓		✓		Draft PUDLV specifies daily collection and siting of posting boxes
Greece	✗				
Ireland	✓			✓	
Italy	✓		✓		Set through internal regulations
Luxembourg	✓		✓		
Netherlands	✓				Commitment in USO to next day delivery implies daily collection
Portugal	✗				Not specified in the USO, though in practice there is daily collection
Spain	✓		✓		Daily collection required
Sweden	✓		✓		Postal Services Ordinance July 1 st 1998
United Kingdom	✓			✓	Not written down in any form, but The Post Office believe that it does form part of the USO requirement

Source: Country appendices

✓ **Specified in the USO**

✗ **Not specified in the USO, but daily collection generally provided in practice**

2.2.7. Letter mail quality-of-service

Information on quality-of-service (QoS) is summarised in Table 2.8. Although all postal administrations are concerned about the quality of the service that they provide, practice differs in regard to the extent to which quality-of-service is included in USOs.

QoS conditions form part of the USO in Belgium, Denmark, France, Germany, Italy, The Netherlands, Portugal, and Sweden, but not in Finland, Greece, Ireland, Luxembourg, Spain and the UK. In Austria quality-of-service obligations may be included in a regulation which is under preparation.

In Denmark the USO specifies delivery standards for the time and speed of delivery, while in Germany the draft PUDLV specifies speed of delivery obligations. In The Netherlands, the Concession Agreement specifies that letters should be delivered next day, but does not set out specific targets for measuring the achievement of this task. In Portugal quality-of-service is incorporated in the annual price review, since the extent to which CTT Correios is allowed to raise prices is dependent on their achievement of a weighted QoS target, which combines performance in speed of delivery, mail not delivered within specified periods, and queuing times at counters. In Sweden, the new delivery targets in the Postal Services Ordinance, which is effective from July 1st 1998, specify that at least 85 per cent of the mail which has been deposited for overnight delivery before the final collection must be distributed the following day, while at least 97 per cent of such mail should be delivered within three working days.

Most other countries which do not have a USO with regard to quality-of-service do nevertheless measure performance against internal targets. Finland Post has its own delivery targets. An Post in Ireland publishes performance figures in its Annual Report, and is in the process of changing the sampling procedure used to measure performance. EPT in Luxembourg does not have a USO objective with regard to delivery targets, but publishes figures on its performance. Correos in Spain publish performance figures in their Annual Report. In Britain Royal Mail publish tables in the Post Office annual report, and detailed brochures, on performance in individual postcode areas. The brochures are available in post offices.

Table 2.8
Letter Mail: Quality of Service

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria					May be included in the regulation that is in preparation
Belgium	✓		✓		Delivery standards for different types of letters, queuing at counters, defined in the Contract de Gestion
Denmark	✓		✓		USO specifies delivery standards for time and speed
Finland	✗				Internal QoS standards
France	✓		✓		Targets in Contrat de Plan 1995-97
Germany	✓		✓		Draft PUDLV specifies speed of delivery obligations
Greece	✗				No regular statistics collected
Ireland	✗				Detailed statistics collected and published: methods being revised
Italy	✓		✓		
Luxembourg	✗				Not part of the USO but statistics collected & published
Netherlands	✓		✓		Requirement for next day delivery. Performance published in Concession Report
Portugal	✓				QoS performance is part of annual price review
Spain	✗				QoS statistics published in Correos Annual Report
Sweden	✓		✓		Postal Services Ordinance July 1 st 1998
United Kingdom	✗				Very detailed statistics are collected and published

Source: Country appendices

✓ **QoS forms part of the USO**

✗ **QoS does not form part of the USO**

2.2.8. Concessions for press or other printed material

Concessions for press and/or other printed material form part of the USO in some Member States but not in others. There are no such concessions in Finland (since 1995), Germany, Ireland, Sweden, and the UK

In The Netherlands there was a legal dispute between PTT Post and publishers as to whether PTT Post were obliged to give concessions for certain printed matter: according to PTT Post (now TPG) this matter has now been resolved, and the concession is being withdrawn.

In contrast, there are extensive concessions in Italy.

In Austria the state can compensate the postal administration for losses on newspaper traffic (which is defined quite widely), and which we therefore regard as falling within the USO.

In Belgium the state has specific powers to require La Poste to set tariffs below costs for newspapers and periodicals, as well as election and other public material. La Poste is reimbursed directly by the state for these concessions.

In Denmark Post Denmark is partly re-imbursed by cross-subsidy from the reserved area, and partly by direct subsidy from the state.

In France, the carriage of newspapers is part of the USO, and the tariff for doing so is set by decree. La Poste is reimbursed for losses incurred as a result, but NERA was informed that the method used by the Inspection des Finances to estimate the losses produced a significant underestimate.

In Luxembourg compensation takes the form of a reduction in state taxes on the postal operator EPT.

Table 2.9
Concessions for Press and/or other Printed Material

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✓	✓			Act defines newspaper delivery as being eligible for a grant from the government. Implication is that newspaper delivery is part of the USO
Belgium	✓		✓		
Denmark	✓		✓		Post Denmark subsidised by cross-subsidy & state subsidy
Finland	✗				Subsidies for newspaper delivery ended in 1995
France	✓	✓			Tariffs for carriage and distribution of newspapers fixed by decree
Germany	✗				
Greece	✓				
Ireland	✗				
Italy	✓	✓			
Luxembourg	✓				EPT receives compensation in the form of tax reduction
Netherlands	✗				Subject of legal dispute between PTT Post and publishers as to whether this was part of USO
Portugal	✓				
Spain	✓				
Sweden	✗				
United Kingdom	✗				

Source: Country appendices

✓ **Provided under USOs**

✗ **Not provided under USOs**

2.3. Existing USOs for Parcels Traffic

Table 2.1 shows the extent of USOs in parcels services. Generally parcels are delivered throughout the national territory, and in most countries there is a uniform tariff obligation for parcels which are covered by the USO. However, there are exceptions. For example, in Portugal there is a zonal pricing system for parcels.

Parcel delivery every five working days forms part of the USO in every Member State, but delivery of parcels on Saturdays takes place only in France, Germany, Italy, and the Netherlands. In the UK, the standard parcel service is a five-days-a-week service, although in practice some delivery takes place on Saturdays. While letters delivery on Saturdays forms part of the USO in Denmark, this is not the case for parcels, which are only delivered five days a week.

In The Netherlands the USO conditions in the "General Postal Guidelines" apply equally to letter mail and to parcels services.

Delivery to the door is less common for parcels than for letters. Obviously parcels are more difficult to deliver than letters, since if the potential recipient is out, then unless there is an appropriate place to leave it, alternative arrangements must be made. These usually involve the recipient collecting the parcel from the delivery or other office, though sometimes the postal operator may deliver to an alternative time specified by the addressee.

Delivery conditions for parcels for those countries in which all addresses do not receive doorstep delivery differ as follows:

- In Austria 88 per cent of addresses receive parcel delivery to the door;
- In Finland, parcels are delivered to the nearest post office if the address is within five kms unless a surcharge is paid: but parcels are delivered free if the address is more than five kms from the nearest post office;
- In Greece parcels are delivered in district capitals only if a premium is paid: if not, and in all other areas, parcels must be collected from the nearest post office;
- In Portugal, parcels are delivered to the address by prior agreement and on payment of an additional charge: otherwise parcels must be collected from the nearest post office; and
- In Sweden parcels are delivered to the nearest post office in urban areas, and to the door or to groups of post boxes in rural areas.

2.4 USOs in Regard to the Provision of a National Network of Counters

As shown in Table 2.10, the provision of a national network of counters forms part of the formal USO in a few countries (Germany, The Netherlands, Sweden, the UK), and part of the informal USO in most others. We were informed in our interviews in many countries that there was no written obligation to provide unprofitable counter services, but that nevertheless attempts to close unprofitable counters had met (or would meet) political opposition. In Ireland An Post's 1990/91 Viability Plan proposed a number of measures to improve the postal administration's financial prospects, including the closure of 554 sub-offices (out of a total of 1951 operated at the time). However these closures were not permitted, and we were told that closures were still not a practical option. In France, the Ministry of the Economy, Finance and Industry has the final power over post office closures, and there has been a moratorium in force since 1993 as part of a wider policy of preventing government departments from increasing unemployment. In Portugal and Spain both Correios and Correos are free in principle to close counters, but their ability to do so is in both countries limited by political considerations.

For those countries in which provision of a national network of counters forms part of the formal USO, the obligation varies between a general obligation to provide a national network (as in the UK), to specific obligations with regard to the siting of facilities. Thus, in Germany the draft PUDLV specifies maximum distances to counters in built-up areas. In The Netherlands, there are specified limits on the siting of offices.

In Denmark, counters are the joint responsibility of Post Denmark and the Ministry, with ministerial discretion as to which counters are closed. There have been some closures in recent years.

Table 2.10
Provision of a National Network of Counters

Member State	Part of the USO	Defined in legislation	Defined in other written form	"Custom & practice"	Exemptions, and other notes
Austria	✓			✓	No specific standards for number and location of counters
Belgium	✓		✓		At least one post office per commune, and no more than 5kms between counters
Denmark	✓				Joint responsibility of Ministry and Post Denmark
Finland	✗				No formal obligation
France	✗				Ministry has final power over reduction in nos of post offices: moratorium since 1993, but La Poste does not measure profit/loss of individual offices
Germany	✓		✓		Draft PUDLV specifies maximum distance to counters in built-up areas
Greece	✗				
Ireland	✓			✓	Attempt to close down unprofitable rural counters in early 1990s failed due to political opposition
Italy	✓				Very difficult to close in rural areas due to political opposition
Luxembourg	✗				Rural counters considered unprofitable, but no data available
Netherlands	✓		✓		In General Postal Guidelines
Portugal	✓			✓	In principle CTT is free to close counters, but ability to do so limited by political considerations
Spain	✓			✓	In principle Correos is free to close counters, but ability to do so limited by political considerations
Sweden	✓	✓			1994 Postal Services Act
United Kingdom	✓		✓		Government committed to "nation-wide network of post offices"

Source: Country appendices

✓ **Provided under USOs**

✗ **Not specified under USOs**

2.5. The Next Step: Measuring the Extra Burdens Imposed by These USOs

Having defined the postal Universal Service Obligations actually imposed in each Member State, the next step is to measure the extra burdens imposed by these existing USOs. This requires:

- A broad **methodology** to define and measure the extra burdens which USOs impose;
- A **framework** to operationalise this methodology given data availability; and
- **Data** of the required type to utilise the methodology and the framework to provide **estimates** of extra USO burdens.

These steps from **methodology**, to **framework**, to **data**, to **estimates** are the subject of the following three chapters. Chapter 3 describes the **methodology** adopted in this study, based on our analysis of previous work in this area and our assessment of the appropriate way to proceed. Chapter 3 and the supporting appendix, appendix A, are based closely on the document supplied to participants in advance of the meeting held in Brussels on June 25th, but we have taken the opportunity to review the arguments advanced at that meeting regarding the use of alternative methodologies. Chapter 4 describes the **framework** within which NERA is estimating USO burdens for postal services in Member States, and particularly the framework used to estimate the burden of universal service. Chapter 5 provides our **estimates** of present USO burdens, and identifies gaps where absence of data has limited our ability to provide USO estimates for all individual Member States.

3. RECOMMENDED USO COSTING METHODOLOGY

3.1. NERA's Recommended Methodology

3.1.1. The overall approach

On the basis of our understanding of the issues, and on the basis of our review of previous work on this subject, both in posts and in telecoms,⁷ NERA believes that the most appropriate interpretation of the burden of the USO in postal services is that of the losses which arise on those parts of the post office business which are covered by universal service obligations, and which would not be provided by a commercial organisation. A profit-maximising postal administration would wish to dispense with these parts of its business or raise their prices, but postal administrations are prevented from abandoning these traffics because of their universal service obligations, and they are in practice usually prevented from raising prices for specific unprofitable parts of their business because of their uniform tariff commitments. However, there may be commercial benefits of providing universal service, and the overall calculation of extra USO burdens ought to take account of these benefits.

We have therefore adopted the following definition of the extra burdens imposed by USOs:

Universal service burdens arise when a postal administration is obliged by government to supply customers or services in circumstances where the overall revenues generated from doing so are less than the costs of supply, taking account of any revenue benefits from providing universal service. Such services would not be supplied at current prices by a commercial organisation if there were no obligation to do so.

This means that the burden of the universal service obligation is equal to the losses on those traffics which are handled at a loss. It is necessary to define these losses. We believe that the appropriate way to do so is by using the net avoided cost (NAC) methodology based on long-run avoidable costs. As we show in our survey of previous empirical work on the costs of USOs in posts and telecoms which is included as Appendix A to this document, this approach is consistent with previous work in this area.

3.1.2. Application of the methodology to the case of universal delivery

We can illustrate this approach by reference to the obligation to provide universal delivery to all addresses in the postal administration's geographic area, **at a uniform tariff**. The nature of the structure of post office costs, and particularly delivery costs, means that deliveries to densely populated areas will be less costly than deliveries to sparsely

⁷ This review is included as Appendix A to this report.

populated areas. In turn this means that, if the postal administration is operating under an overall break-even financial constraint, then deliveries in densely populated areas will be profitable, but those to sparsely populated areas will be unprofitable. (It also means that the postal administration will usually need some protection from competition for its profitable traffics: this is usually achieved by reserving certain type of business for a postal monopoly.⁸)

Our approach to the USO burdens of universal delivery is illustrated in Figure 3.1.⁹ The vertical axis shows the tariff per unit of traffic carried, while the horizontal axis shows total traffic carried, ranked in terms of increasing cost per unit of traffic handled. If the operator breaks-even,¹⁰ then the profit on the lower cost traffics (area abc) will be exactly balanced by the losses on the higher cost traffics (area cde, ie area A) if all costs are attributed in one way or another to the different traffics. **We interpret the cost of the USO in this diagram as equal to the area A.** In this case the whole of the USO is funded by the profits that the postal administration earns on the rest of its traffics, that is to say, by cross-subsidy.¹¹

The size of the USO costs as defined above clearly depends on the pattern of costs. If unit costs for most traffic are fairly constant, but there is a “tail” of high cost traffic then the USO cost, area A, will be relatively low, as in Figure 3.2 . On the other hand, if there is a wide dispersion of unit costs across the whole spectrum of traffic, then the USO cost, area A, will be relatively high, as in Figure 3.3.

This means that burdens in practice will depend on:

- the steepness of the unit cost curve, that is to say, the extent to which the costs of handling different traffics vary across the business;
- the proportion of the total traffic that does not cover costs; and
- the extent to which price covers costs: if the postal operator sets a price that yields a profit rather than just leads to break even, this will reduce the burden of the USO, since a higher price reduces the size of area A.

If a postal administration were required to provide universal delivery, but were not constrained by a uniform tariff so could choose how to charge for the different traffics, then the administration might increase the charges for its unprofitable traffics, and thereby reduce (or even eliminate) the losses and hence the USO burden.

⁸ The reserved area need not necessarily encompass all of the profitable traffics.

⁹ A similar diagram appears in the European Commission's 1992 Green Paper on the development of the single market for postal services (European Commission, 1992, p.118).

¹⁰ By which we mean that it also earns a satisfactory return on capital invested.

¹¹ Some commentators have argued that in this case the cost of the USO is zero, because there is no cost of funding the USO that needs to be met by an external body. This is not the approach that we adopt in our study.

However, as we have seen in chapter 2, most European postal administrations are obliged not only to provide universal delivery, but also to provide this at a uniform tariff.¹² Since our remit for the present study is to take account of the current extra burdens of USO obligations as they are presently interpreted in each Member State, this means that the extra burden of the universal delivery obligation is indeed area A where there is a uniform tariff requirement.

Figure 3.1
The Cost of the Letter Delivery USO

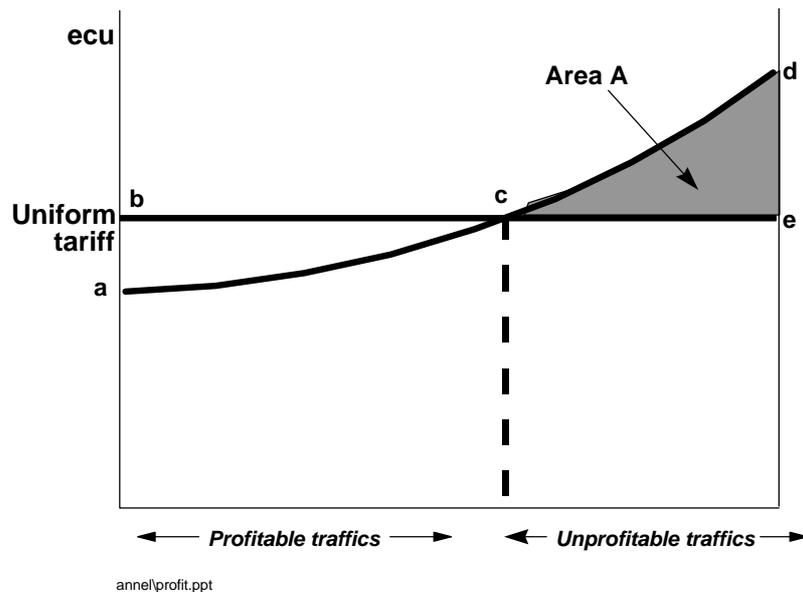
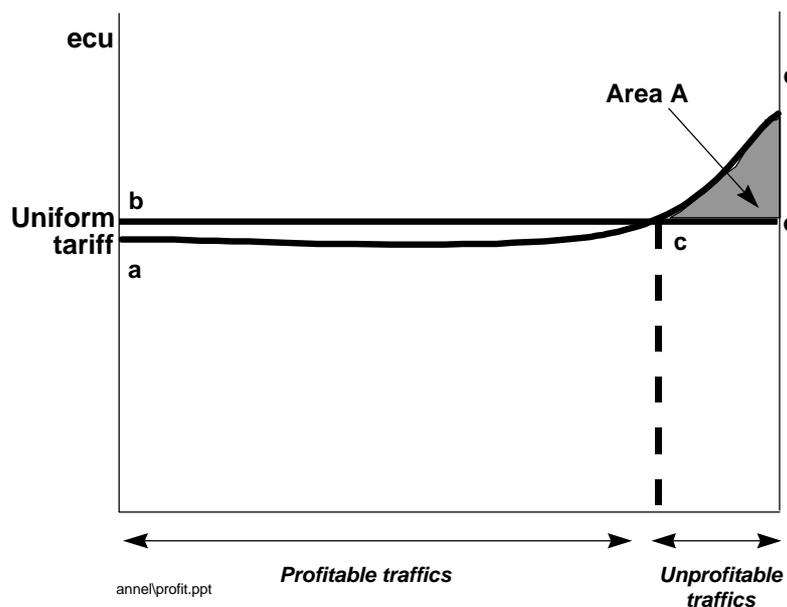
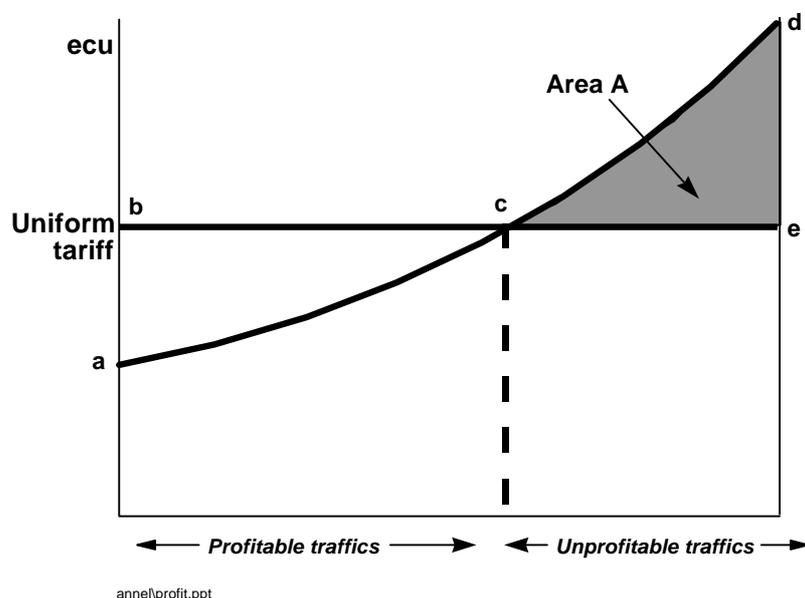


Figure 3.2
Cost of the USO with a “Tail” of High Cost Traffics



¹² In some countries discounts are permitted, so the uniform tariff might strictly be regarded as a maximum tariff.

Figure 3.3
Cost of the USO when there are Large Variations in Unit Costs
Across the Postal business



3.1.3. Identifying postal USO costs in practice

The diagrams described in the previous section show a stylised situation, and do not consider the distinction between short-run costs and long-run costs. In practice we need to consider how these losses are actually to be estimated. This in turn requires us to decide which costs need to be associated with traffics that might be unprofitable, and which revenues should be associated with these traffics.

First with regard to costs, we need to identify those costs which are specific to particular traffics. The extent to which costs can be identified as specific will depend on the level of disaggregation. For example, if we consider an individual letter delivered by a postman in the course of his round, there may be very few specific costs that can be allocated to that letter. If the letter is one of a number delivered to a particular address on that day, then there will be no saving in costs if that letter is not carried. On the other hand, if this is the only letter to that address that day, then there will be some additional cost of delivery in that the postman will have to walk, cycle or drive a little further to deliver the letter.¹³

It is more sensible to consider whether the revenue from providing daily delivery facilities to a specific address covers the cost from serving that address, over a period of time such as a year. This means that every working day the post office provides facilities which would enable it to deliver if mail were to be sent. In practice, the post office will know the volumes

¹³ Because of indivisibilities, this will not be reflected in day-to-day variations in costs, but in the longer term additional traffics will be reflected in the design of rounds and the resources that need to be applied to serve a particular area.

of mail likely to be on offer, and so it will provide facilities able to cope with the likely volumes of mail. Since not every address may receive mail every day, this means that the delivery capacity provided will normally be able to handle the demand (and where it cannot, some rearrangement of delivery responsibilities, typically the use of overtime, will usually be able to handle any occasional unexpected peaks in demand).

In such circumstances most of the delivery costs might be said to be common to the postman's round, which might be identified as a possible level of disaggregation. In other words, universal delivery requires the postal administration to structure its delivery network in such a way that it can deliver to all the addresses that are likely to need postal deliveries on any particular day of the week covered by the USO obligation (and by any associated obligation to deliver by a particular time of day).

There are two principal drivers of the unit cost of delivery. These are:

1. The cost of serving a particular address. This will primarily depend on the density of points to be covered, which will determine the number of delivery points that can be served per hour by foot, by cycle or by motor vehicle; and
2. The volume of mail to be delivered to each address: the more mail delivered to an address, the lower will be the unit cost of delivery per item.

If we were to take the postman's round as the basic unit of aggregation, then we can first consider if the revenue earned from the items delivered on that round covers the delivery costs. If it does not, then the round is clearly unprofitable. The loss over delivery cost is an element of the USO cost as we have identified it. To be added to this loss is any savings in the other costs, collection, sorting and trunking, if these traffics which did not cover their delivery costs were to be withdrawn.

We then need to consider traffics whose revenue covers delivery costs. If these traffics were withdrawn, then there might be some savings in clearance/collection, sorting and transport costs.¹⁴ If the savings in these other costs, plus the savings in their delivery costs, exceeded the revenue earned, then these traffics too should be withdrawn to increase profits. The extent to which USO costs would rise will therefore depend on the extent to which these items of post office costs are jointly incurred with other traffics.

We believe that this should be considered by taking a long-run view of postal distribution networks. Existing sorting and transport networks are generally designed to handle current volumes of traffic between the set of collection points designed to provide universal collection facilities, and the set of delivery points which ensure universal delivery. If there were a sudden drop in postal volumes because not all delivery points were served (and

¹⁴ If there were constant returns to scale in all these functions then the long-run cost savings would be pro rata to volume savings. However, there might be some economies of scale in collection, trunking and automated sorting. The structure of these costs in practice is a subject being investigated in this study.

some collection facilities were withdrawn) then there might be relatively few short-term savings in resources and hence in costs. However, if significant volumes were lost, then the optimal postal sorting and transport network would be different, and could be redesigned to handle the lower volumes. In consequence there would be cost savings, and we believe that these savings are relevant in determining total USO burdens.

The logic described above is the logic of the net avoided cost (NAC) approach to USO cost estimation, with avoided costs estimated on a **long-run** avoidable cost basis.¹⁵ However, while our discussion suggests that the basis of analysis might be the individual postman's delivery round, in practice we did not expect to be able to obtain data at this level of disaggregation. As a consequence, in the present study we have sought to obtain data at what might be considered as the next level of aggregation, namely the individual delivery office.

3.1.4. Interdependence of revenues and costs

Just as costs may be interdependent, so too may be revenues. This can occur in two main ways:

1. If some people do not receive mail delivery, then they may post fewer letters, so there may be fewer letters posted to low delivery cost addresses from residents of high delivery cost areas; and
2. Mailers may derive benefits from knowing that they can mail to every address in the country. If this is the case, their willingness to use postal services to serve the remaining part of the network may be reduced. We refer to this as the benefit of "ubiquity".

Both of these factors would lead to a reduction in the financial burden which universal service imposes on the postal operator.

3.2. Alternative Definitions of USO Burdens

3.2.1. An economic welfare approach

Some researchers, notably Golay and Dobbs (1996), have suggested that estimates of USO burdens should consider not only the financial losses to postal operators, but also losses of consumer surplus. These losses arise because, with a uniform tariff, consumers of profitable postal services are required to pay prices that exceed the costs of provision, while the consumers of unprofitable postal services are able to pay prices which fall short of the costs

¹⁵ The long-run situation is one in which optimal networks would be redesigned to take account of the lower traffic volumes that would need to be handled.

of provision. Since economic efficiency is achieved where prices are equal to (marginal) costs, this creates a welfare loss in economic efficiency terms.

Golay and Dobbs' paper considers this by considering the welfare burden of a uniform price imposed in addition to a requirement to provide universal service. There are two components of this burden, which are added together to find the total welfare burden. These two elements are:

1. loss of profits; and
2. loss of consumer surplus.¹⁶

Golay and Dobbs develop a framework to assess these by maximising economic efficiency subject to a maximum price cap or subject to a profit constraint. Economists refer to the resulting prices, where economic efficiency is maximised subject to a constraint, as second-best, or Ramsey prices. These prices involve differential mark-ups over marginal costs which are inversely related to price elasticities of demand, ie the less sensitive is demand to price, the greater will be the mark-up of price over marginal costs.¹⁷

Golay and Dobb's approach is correct when the objective is to maximise economic efficiency. However, it does not take account of the fact that a major justification for the existence of a uniform tariff lies in equity arguments.¹⁸ Golay and Dobbs' approach seeks to find the set of postal prices that will maximise economic efficiency subject to a price-cap or profit constraint, and it is certainly true that economic efficiency is not achieved when one set of consumers cross-subsidises another. However, the uniform tariff is generally imposed not for reasons of economic efficiency, but for reasons of equity, such as the desire to ensure that all citizens are able to access essential facilities such as the ability to receive postal deliveries. In such circumstances the benefits to society of delivery to unprofitable areas are not fully reflected just in the prices that consumers are prepared to pay to send letters to such areas, and so the benefits of, for example, rural delivery cannot just be measured in terms of willingness-to-pay.

3.2.2. USO burdens under liberalisation: alternative views at the Commission meeting of 25th July 1998

In their paper presented at the meeting at the Commission in Brussels on June 25th, Royal Mail argued for another measure of the burden of the USO.¹⁹ In effect, this measure is equal

¹⁶ Consumer surplus is the excess above price that consumers would be prepared to pay to consume a good or service, over and above what they actually pay.

¹⁷ Dobbs and Golay suggest that demand for postal service is relatively price inelastic, and they quote a short-run price elasticity in the range -0.2 to -0.4. They are, however, unable to indicate how elasticities might vary between different traffics, which means that they cannot indicate how mark-ups will vary between different postal traffics.

¹⁸ A similar point is made by Gallet and Toledano (1997, p.13).

¹⁹ A very similar paper was presented to the Sixth Conference on Postal and Delivery Economics in Montreux Switzerland on 20th June (Rodríguez, Storer and Smith, 1998).

to the loss of profit which **an efficient postal operator** would suffer if the market were to be liberalised.

Royal Mail describe their approach as “the entry pricing approach”. This is because the first step in the approach involves the identification of the costs which potential competitors would face if they were to enter different parts of a liberalised market. It is then necessary to predict the extent of competition which would occur as a result. The approach next requires a prediction of how such competition would impact on the profits of the postal operator who had previously had exclusive rights to serve the now-liberalised market.

As indicated above, NERA interprets the Royal Mail measure as being equal to the value of its existing profits which an efficient postal administration would lose if it were to operate under a liberalised regime when it faced competition in the market for profitable (and currently protected) traffics. Although it may be these profits which support the losses on the USO-imposed parts of the business, **we do not think it is appropriate to interpret them as a measure of the burden of the USO itself.**

Ex ante, the estimates of the profits to be lost as a result of competition would be very difficult to predict, and would likely involve a range of values resulting from a range of different liberalisation scenarios. Ex post, the danger is that any national postal operator in a liberalised market would argue that (1) they **were** an efficient operator, and (2) all the loss of profit they suffered represented a USO burden and so should be recompensed.

La Poste's presentation on June 25th largely consisted of a critique of NERA's appendix reviewing previous work on USO cost/burden estimation. We believe that the essence of these criticisms is that NERA should not be attempting to estimate the burden of the USO under a static framework under which postal administrations retain their monopoly. However, our Terms of Reference require us to estimate the existing USO burdens in Member States, most of which are not liberalised. We contend that the value of these burdens, which have not previously been measured, is an essential starting point to assess the future value of such burdens in a more liberalised environment.

Deutsche Post's presentation on 25th June²⁰ outlined the views of Deutsche Post AG. They identified the following requirements for a method for measuring USO burdens:

- it should be applicable to measure the USO burden in a (partly) liberalised environment;
- it should take the essential USO constraints of the respective country into account;
- the calculation measure should identify the cost and revenue structure with and without the USO;

²⁰ Jens Kirchner "Universal service costs - the view of Deutsche Post AG".

- it should measure the USO burden independently of the type of financing system; and
- it should be practically implementable and customisable.

After reviewing the geographical requirements and the QoS obligations facing DP²¹, the presentation contrasted the NERA and the Royal Mail approaches. DP noted that Royal Mail's approach has no clear distinction between costing and financing, and that it is inapplicable for DP. On the other hand the NERA approach is "basically applicable as part of Deutsche Post USO calculations". The overview of the DP approach to actual measurement which concluded the presentation suggests more emphasis on the costs of alternative levels of service provision than has been possible in NERA's own work.

The fourth presentation by a postal administration on 25th June (though the first one actually to be presented) was by CTT Correios of Portugal.²² This presentation first reviewed the characteristics and extent of universal service provision in Portugal, including the new legal framework and the licence agreement between the state and the public postal operator. The second part of the presentation described the methods being used to provide practical estimates of the USO burden using fully-distributed cost (FDC) measures, allocating costs between operational and overhead costs, and between activities (counters, sorting, transport, delivery) and products. Once the cost of the USO burden has been estimated within a static framework, a final stage will use a dynamic approach to estimate the impact of the progressive entry of new operators.

²¹ Including the fact that its employees are public sector employees, a consideration which NERA contends should not be regarded as part of the USO burden.

²² "Some methodological aspects to consider for the evaluation of the cost of Universal Service Obligation (USO) - View of CTT Correios", Antonia Rato.

4. ESTIMATING THE COSTS OF THE EXTRA BURDENS IMPOSED BY USOS

4.1. Introduction

This chapter presents the framework we have adopted to operationalise the methodology described in chapter 3 to estimate the costs of the extra burdens imposed by USOs. In the following chapter we will present estimates of these burdens of universal delivery, discuss estimates of additional costs imposed by an obligation to deliver on Saturdays, provide estimates of costs of concessions for newspapers and other published material and for government or other public material, describe two estimates of the costs of providing free services for the blind and partially-sighted, and discuss the issues involved in deriving estimates of extra USO burdens associated with post office counters.

4.2. Burden Imposed by USOs: the Views of Postal Administrations and Ministries

Having identified the nature of existing USOs in the individual Member States, as described in chapter 2, we next needed to determine whether postal administrations and/or ministries had made any estimates of the extra burdens that these impose. Although some studies are under way, no postal administration nor any sponsoring ministry was able to provide any estimates of the extra burdens that universal service imposes in their country. This means that there are no estimates of USO burdens which we could compare with our own estimates, for example in order to see the extent to which different methodological approaches yield different results.

4.3. Estimating USO Burdens of Universal Delivery: the NERA Model

This section explains the framework which NERA has developed to estimate the burdens of USOs in each of the fifteen Member States of the EU. This framework was designed to utilise the data from a number of sources in as **effective** and **transparent** a manner as possible. The data sources are:

- Information from postal administrations obtained in the course of our interview programme;
- Published data, particularly from postal administrations' annual reports and accounts; and
- NERA interpretations of economic parameters.

A further major feature of the framework is that it is able to show the sensitivity of the results to changes in data and parameter values, and that it is straightforward to change values as data are refined as the study proceeds towards completion.

Although we believe (see above, chapter 3) that the appropriate methodology for USO burden estimation is that of long-run net avoided costs (NAC), the model also enables burdens of universal service provision to be estimated on the alternative, fully-distributed cost (FDC) basis, so that the results of the two methods can be compared.²³

The main features of the calculations are:

1. A cumulative ranking of mail volumes by increasing unit cost;
2. A split of total costs into major functions, namely: collection/clearance; outward sorting; transport/trunking; inward sorting; delivery; and unallocable overhead costs; or combinations of these.
3. An evaluation of the impact of changing traffic volumes on costs of the different functions other than delivery (in economic terms, this is summarised by an estimate of the elasticity of the particular type of cost with respect to output).²⁴
4. A delivery cost function which shows how unit delivery costs vary across the total volume of mail delivered. Since data availability varies from country to country, the program incorporates considerable flexibility in the way that this delivery cost index can be input.

As well as the data requirements listed in 1 to 4 above, the user is also required to input:

1. The average price per unit of mail handled. This can normally be calculated from the type of information usually published in annual reports and accounts,²⁵ though care has to be exercised in excluding any revenue earned from non-postal activities.
2. The average cost per unit of mail handled. Again, this can normally be calculated from the type of aggregate information usually published in annual reports and accounts, though again care has to be exercised, this time in excluding any costs incurred in providing non-postal activities; and
3. Total annual mail volumes.

The program outputs calculations of USO burdens, but the logic of the model and its calculations are best understood by viewing three sets of figures which show, for each

²³ The model has the facility to consider letter mail and parcels mail separately, though in practice we did not have detailed enough data for parcels to do this in this study.

²⁴ This is usually one of the outputs of econometric models of postal (or other) cost functions, and can be obtained from surveys of econometric cost analyses in the sector.

²⁵ Basically, total revenue, and the total mail volume handled, in the latest year for which data are available.

country, the pattern of delivery costs per item, and the patterns of fully-allocated costs and avoidable costs across the spectrum of mail delivered.

4.3.1. Unit delivery costs

Figure 4.1, Figure 4.2 and Figure 4.3 show different patterns of delivery costs in different imaginary countries.

Figure 4.1 shows a country in which there is no significant variation in delivery costs across the whole country. In such a country there would be no USO burden of universal delivery unless **all** deliveries were unprofitable because of regulated prices.

Figure 4.2 shows a country in which data are only available on differences in delivery costs per item, and total traffic volumes, between urban and rural areas. In this, imaginary, case, delivery costs per item in rural areas are three times delivery costs per item in urban areas, while traffic volumes are split equally between urban and rural parts of the country. Information on this type of ratio between delivery costs in the two types of area has been published in previous studies of postal costs,²⁶ though in the present study we have tried to obtain results on the basis of much more detailed patterns of unit delivery costs.

Figure 4.3 shows a country for which detailed data on variations in delivery cost are available. The curve in the chart is now a smooth curve. This is the ideal form in which we have been collecting information.²⁷

4.3.2. USO burdens on a fully-allocated cost basis

Figure 4.4, Figure 4.5 and Figure 4.6 show fully distributed costs for the delivery cost indices discussed above, and for the proportions of costs allocated to different functions in the European Commission's 1992 Green Paper.²⁸ We use these proportions as an illustration as they have been published, but in actual estimates described in the next chapter we use data for each country supplied by that country's postal administration during the course of this study.

It is important to note that the curves in the figures show cumulative costs, adding the different components in the following order:

²⁶ See, for example, *Study on the Impact of Liberalisation of Inward Cross-Border Mail on the Provision of the Universal Postal Service and the Options for Progressive Liberalisation* Study for DG-IV.

²⁷ Such data have been obtained for Austria, Finland, Ireland, Portugal and the UK. We also have disaggregated data, in a somewhat different form, for Italy.

²⁸ European Commission (1992) *Green Paper on the Development of the Single Market for Postal Service* p.105. These proportions were: collection/clearance 10%; outward sorting 18%; transport 2%; inward sorting 5%; and delivery 65%. To demonstrate our framework we have also included an arbitrary ten per cent for unallocated overheads, and adjusted the other proportions downwards accordingly.

- Unallocated overheads;
- Collection;
- Inward sorting;
- Outward sorting;
- Transport;
- Delivery.

The program undertakes the calculations in such a way that the delivery cost index is rescaled so that the unit delivery cost values shown in the figures are consistent with the overall proportion of delivery in total costs input into the programme. Because of this scaling mechanism, the loss (above average costs rather than price) on the right hand side of the figure will equal the profit (below average costs) on the left hand side of the figure.

Given the unit price shown in the figures, the loss on unprofitable traffics is the area in the top right hand corner between price and that part of the cost curve which rises above the unit price line. This area measures the burden of the USO if calculated on a fully-distributed cost basis.

As is clear from Figures 4.4 to 4.6, the model in its present form takes unit costs of collection, sorting and transport as invariant across traffics. This is because we did not have data on how these costs do vary across traffics. In any case, delivery costs are both the largest single component of costs,²⁹ and the one where variation is greatest. We consequently cannot calculate any burdens imposed by collection, though we would expect them to be much lower than delivery cost burdens because:

- Collection costs are a much lower proportion of total costs than are delivery costs³⁰; and
- Collection costs are less sensitive to volume changes than are delivery costs.³¹

²⁹ The unweighted average of delivery costs as a proportion of total letter costs for eight Member States is 47.1 per cent.

³⁰ The unweighted average of collection costs as a proportion of total letter costs for eight Member States is 12.1 per cent.

³¹ See section 4.3.3 below.

4.3.3. USO burdens on an avoidable cost basis

Figure 4.7, Figure 4.8 and Figure 4.9 show avoidable costs for the delivery cost indices discussed above, and again for the proportions of costs allocated to different functions in the Green Paper.

These charts allow for the fact that if traffic is not delivered in certain areas, less than 100 per cent of the collection, sorting and transport costs of handling these traffics may be saved.³²

This analysis requires estimates of the sensitivity of different mail-handling function costs to long-run changes in traffic volumes. One source of such estimates are econometric studies, which have been carried out in a number of countries, including France, the UK and the United States.

Aligon et al (1998) have considered sorting costs in La Poste's operations in France. They used data from 90 of La Poste's 125 sorting centres in 1996 to estimate a translog cost function showing how sorting costs vary with traffic volumes, traffic mix and the type of sorting (manual or automatic) used. This approach yields elasticities which show how total costs change with a given percentage change in traffic volume. The results show that:

- If the volume of traffic changed by ten per cent, with the mix between automatic, manual and transit traffic held constant, sorting costs would change by 9.7 per cent;
- If the volume of traffic changed by ten per cent, with the mix between first class letters, second class letters, parcels and newspapers held constant, sorting costs would change by 9.2 per cent; and
- If the volume of traffic changed by ten per cent, with the mix between inward, outward, and international sorting held constant, sorting costs would change by 7.4 per cent.

Recent econometric estimates of sorting costs are also available from studies on the US Post Office. Bradley and Colvin (1998) used data from nearly 250 mail processing sites in the period between 1988 and 1996 to estimate an elasticity of sorting costs with respect to labour input of around 0.7 to 0.75.

In 1998 the United States Postal Service (1998, p.3-3) estimated the following elasticities of sorting costs with respect to letter mail volume:

- Automatic sorting with barcodes: 0.945;
- Automatic sorting with optical character recognition equipment: 0.786;

³² We presume that, in the long run, all the delivery costs are saved if traffic is withdrawn from particular addresses, but the model is able to test the sensitivity of the results to this assumption.

- Mechanised sorting: 0.910;
- Manual sorting of letters: 0.797;
- Manual sorting of flats: 0.866.

In our interviews with them, Royal Mail supplied cost elasticity values as follows:

- Collection: 0.05;
- Sorting 0.84;
- Transport 0.31.

For the demonstration of the model in this chapter we have used long-run elasticity values, based on the above, on the results of our other interviews - which also suggested that collection costs are little affected by changes in mail volumes - and on earlier econometric estimates, as follows:

- Collection: 0.10;
- Inward and outward sorting: 0.80;
- Transport: 0.40.

In the demonstration of the model, and in all our calculations in this report, we assume that there would be no savings in unallocable overhead costs if traffic were lost, though our model can accommodate such savings in its calculations if desired.

Given the unit price shown in Figures 4.7, 4.8 and 4.9, the **avoidable** loss on unprofitable traffics is the area in the top right hand corner between price and that part of the **avoidable** cost curve which rises above the unit price line. This loss is less than that measured on a fully-allocated cost basis because not all costs would be saved if traffic were to be withdrawn.

4.4. Estimating the Costs of Providing Services at Concessionary or Zero Tariffs

In addition to the burden of providing universal service, NERA has also developed a framework to calculate the net additional financial burden to the postal administration of handling traffics at zero or concessionary rates. For these calculations the user needs data on:

1. A description of each type of mail handled at such rates;
2. The annualised volume of such traffic handled;
3. The actual average price at which this mail is handled;

4. The average price which would be charged if this mail was handled at normal rates for mail with those weight etc characteristics;
5. An estimate of the elasticity of mail volume to price charged;
6. An estimate of the unit cost saving if lower volumes of this type of mail were to be carried.

More details of the logic of the calculation are set out in Appendix B.

However, data in this form have not been available, but we have been able to utilise postal operator's own estimates of these costs. These are described in section 5.4 below.

4.5. Costs of Service Enhancements which Form Part of the USO

Where the postal administration is obliged to provide a level of service quality which exceeds that which would be provided by a commercial organisation in a competitive environment³³, it would be necessary to estimate the additional cost of providing the additional service quality, and to subtract from it any additional revenue which results.

The most relevant case is that of sixth day (usually Saturday) delivery. For those postal administrations which do provide sixth day delivery, it is first necessary to determine whether sixth day delivery does form part of their formal or informal USO, or whether it is provided for commercial reasons. Even if it forms part of their USO, it is still necessary to determine whether it might still be provided for commercial reasons in the absence of the obligation. Only if the sixth day delivery would not be provided for commercial reasons is it appropriate to make an estimate of its cost.

This first involves estimating the additional costs of delivery on a sixth day. We would expect most of these costs to be labour costs, since the physical network of buildings, collection boxes, sorting equipment and vehicles is needed to provide service on the other five days of the week. Labour might however have to be paid overtime rates to work on a sixth day. Next it is necessary to estimate any revenue losses that arise when sixth day delivery is not provided. Much material may not be time-sensitive, though some types of traffic, in particular daily newspapers might be lost, and some mail may be, for example, posted on a Friday because the sender expects that it will be delivered on a Saturday and Monday delivery would be too late.

4.6. Burden of Counters which Form Part of the USO

As shown in Table 2.10 earlier, in Austria, Belgium, Denmark, Germany, Ireland, the Netherlands, Portugal, Sweden and the UK national post offices have a formal obligation to

³³ See discussion under sub-heading 3 on page 2 above.

maintain a network of counters. In some cases the density of the network is defined in legislation or other written form. NERA was frequently told at interviews that closing counters is strongly opposed at a political and local level.

It seems intuitively likely that counters with low turnover may be uneconomic and therefore constitute a burden. For example, in the UK many small communities have a post office but no bank branches while high streets in towns and cities have both a post office and a considerable number of banks and other deposit takers. This suggests that, if post office counters carried out broadly the same functions as banks, their distribution and density would be considerably different from the existing networks.

In practice, post office counters compete with banks on a relatively limited range of financial transactions such as deposit taking and money transmission, but they carry out a wide range of other transactions for which they have a *de facto* government monopoly: for example issuing licences and paying benefits. If governments correctly recompense postal administrations for carrying out these services and if the purely postal functions of post office counters are covered by revenue from letters and parcels, then counter networks should not constitute a burden. Further, since governmental services are "reserved" to post office counters, it does not matter if urban post offices subsidise rural. As the Notice on the application of competition rules to the postal sector³⁴ observes: "Cross-subsidisation does not distort competition when the costs of reserved activities are subsidised by the revenue generated by other reserved services since there is no competition possible as to these services".

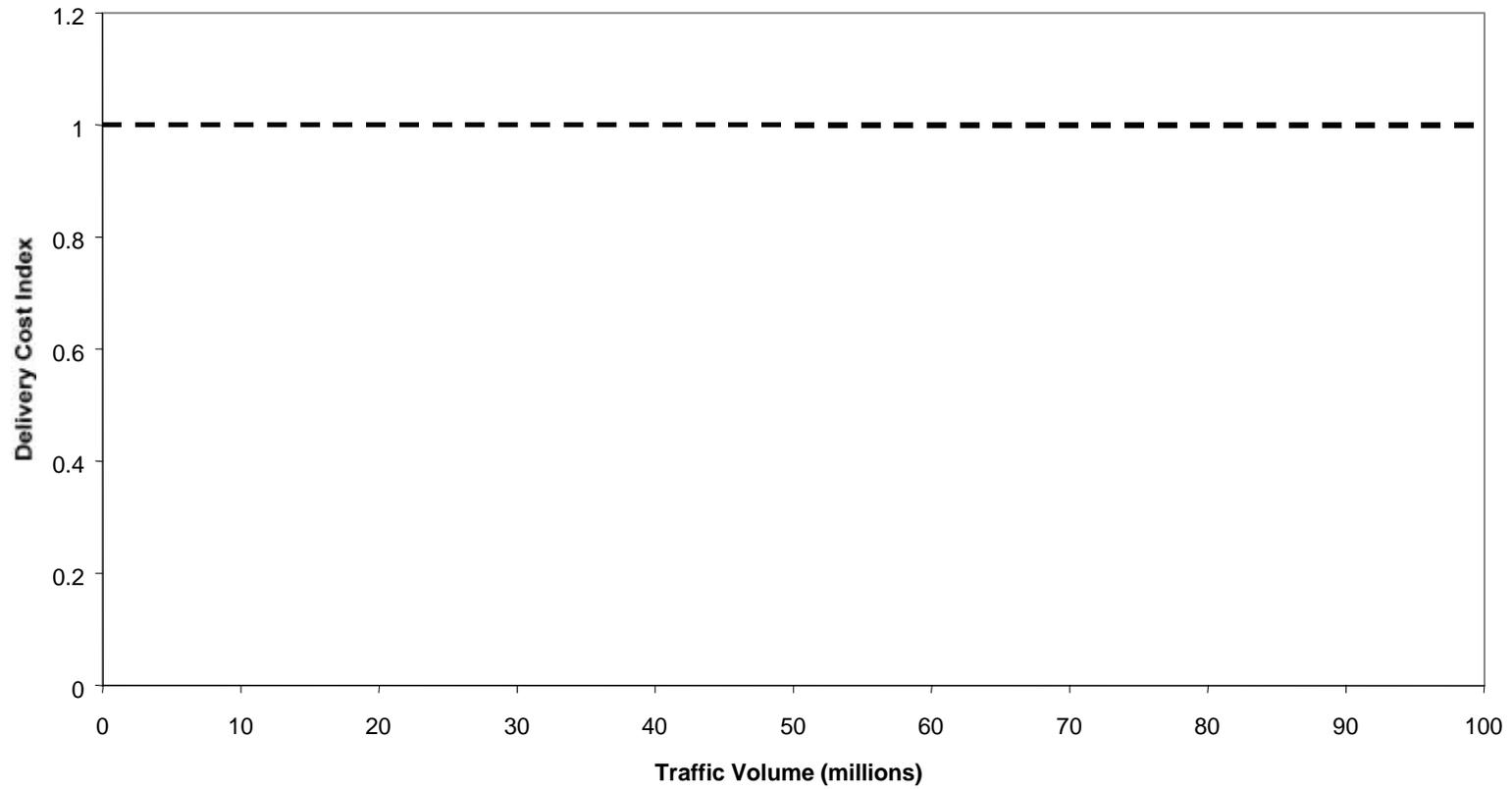
A difficulty arises in determining at what point a network of counters of a given size constitutes a burden. The elasticity of demand for governmental services and for reserved postal services are all likely to be low. Reducing the counters' network imposes more travelling upon customers without reducing their need to take out licences or collect benefits. In the extreme case, a large city could be provided with a single post office without losing reserved traffic, and the postal administration could argue that any additional post offices in that city constituted a "burden".

Most administrations do not constitute their counters network as a separate trading entity or publish separate trading accounts, as does Post Office Counters Limited in the UK. Even if they did so, detailed analysis would still be required to establish whether the *postal* operations of individual post offices or of the entire network — notably the sale of stamps, and receipt of letters and parcels — constituted profitable or unprofitable activities.

³⁴ *Official Journal*. 98/C 39/02, section 3.2.

In the questionnaire and at interviews NERA explored these issues. Several administrations considered that many of their smaller counters were "unprofitable" and so constitute a burden, but could not provide suitable data. Information provided by the Greek, Irish, Italian and Swedish administrations is presented in chapter 5 and the country chapters of Appendix C and D.

Figure 4.1
Delivery Cost Index, Country A



Ecpostpowerpoint\june25 charts.ppt

Figure 4.2
Delivery Cost Index, Country B

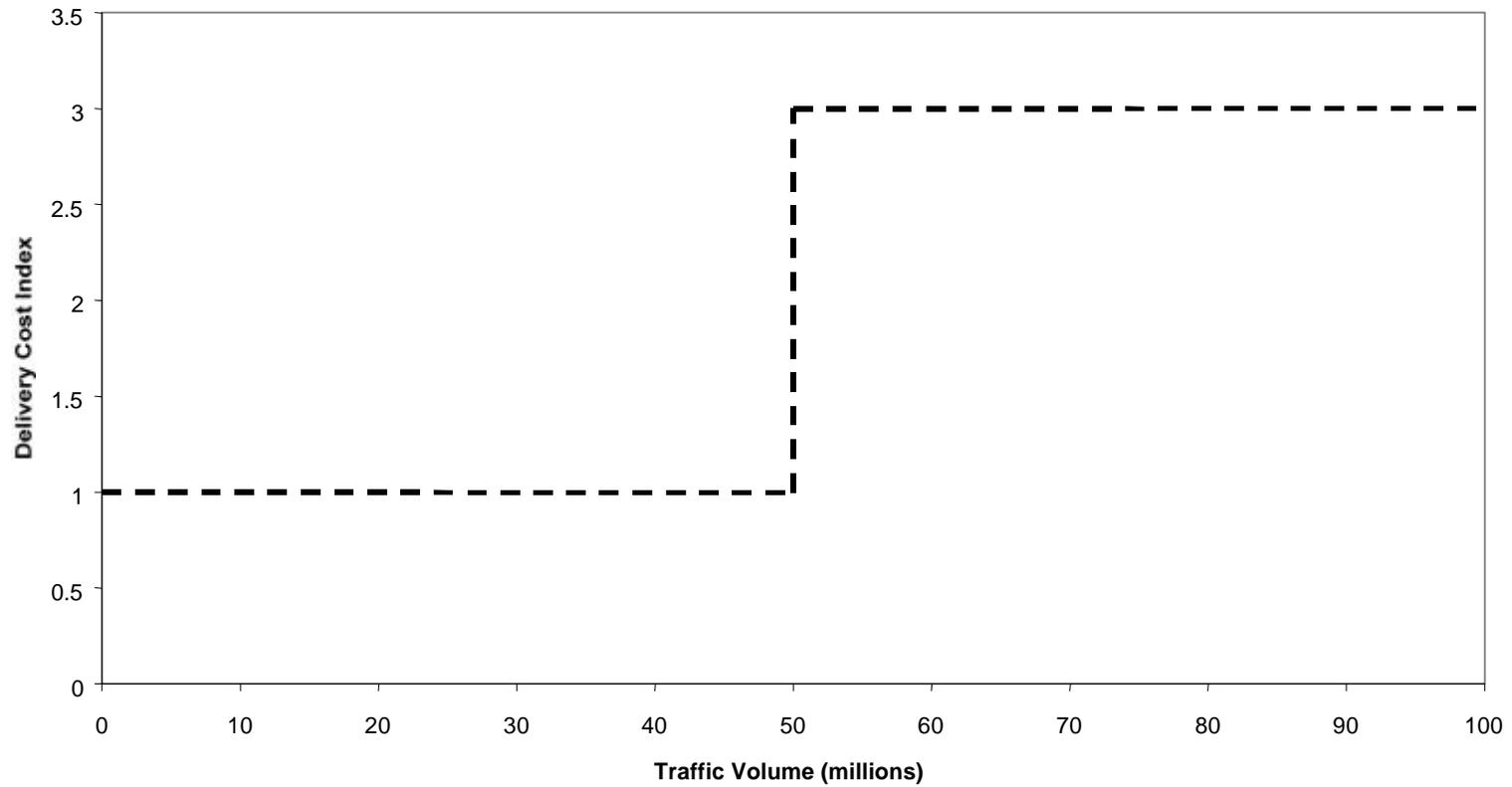


Figure 4.3
Delivery Cost Index, Country C

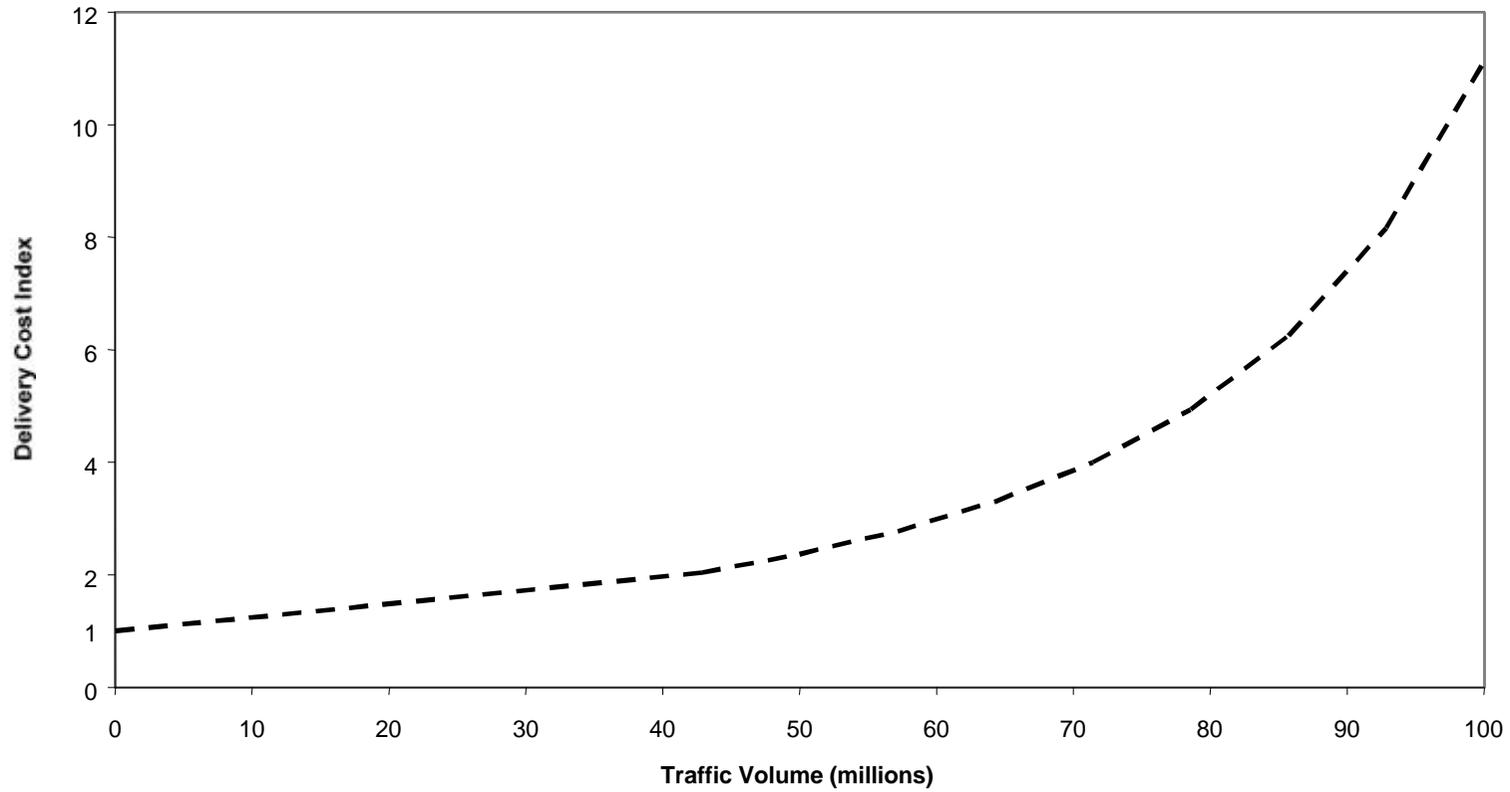


Figure 4.4
Fully Distributed Letter Costs, Country A

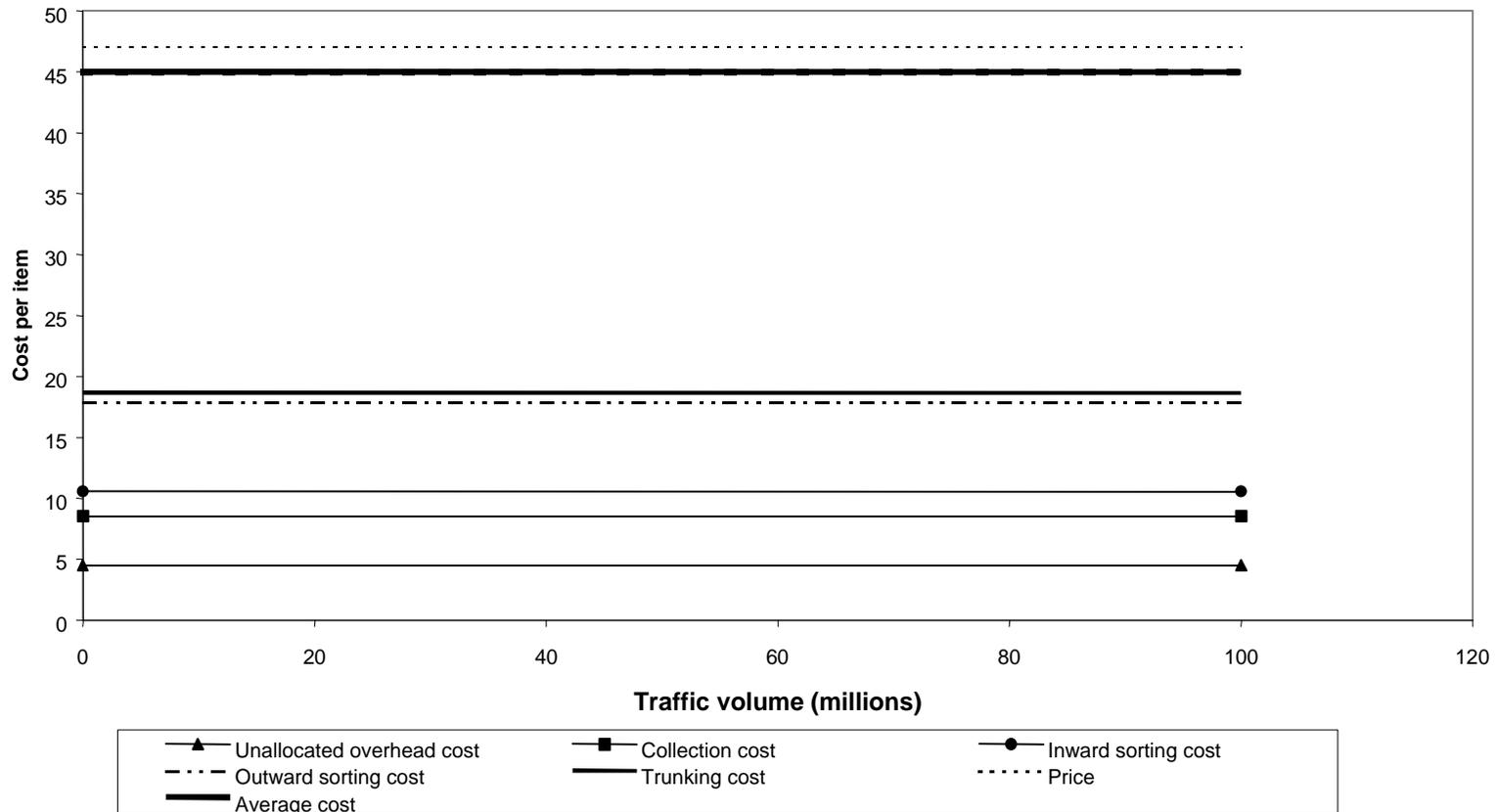


Figure 4.5
Fully Distributed Letter Costs, Country B

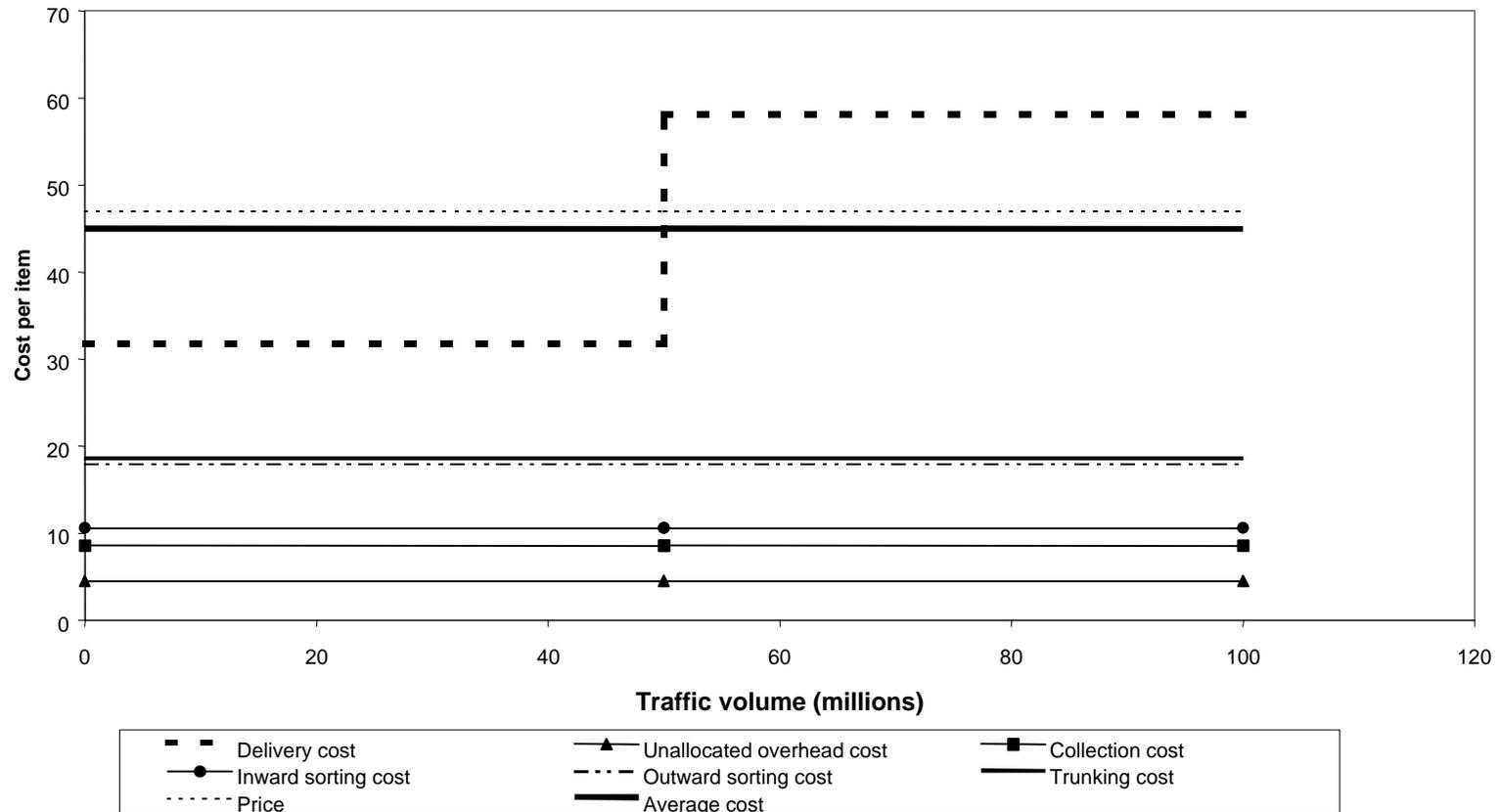


Figure 4.6
Fully Distributed Letter Costs, Country C

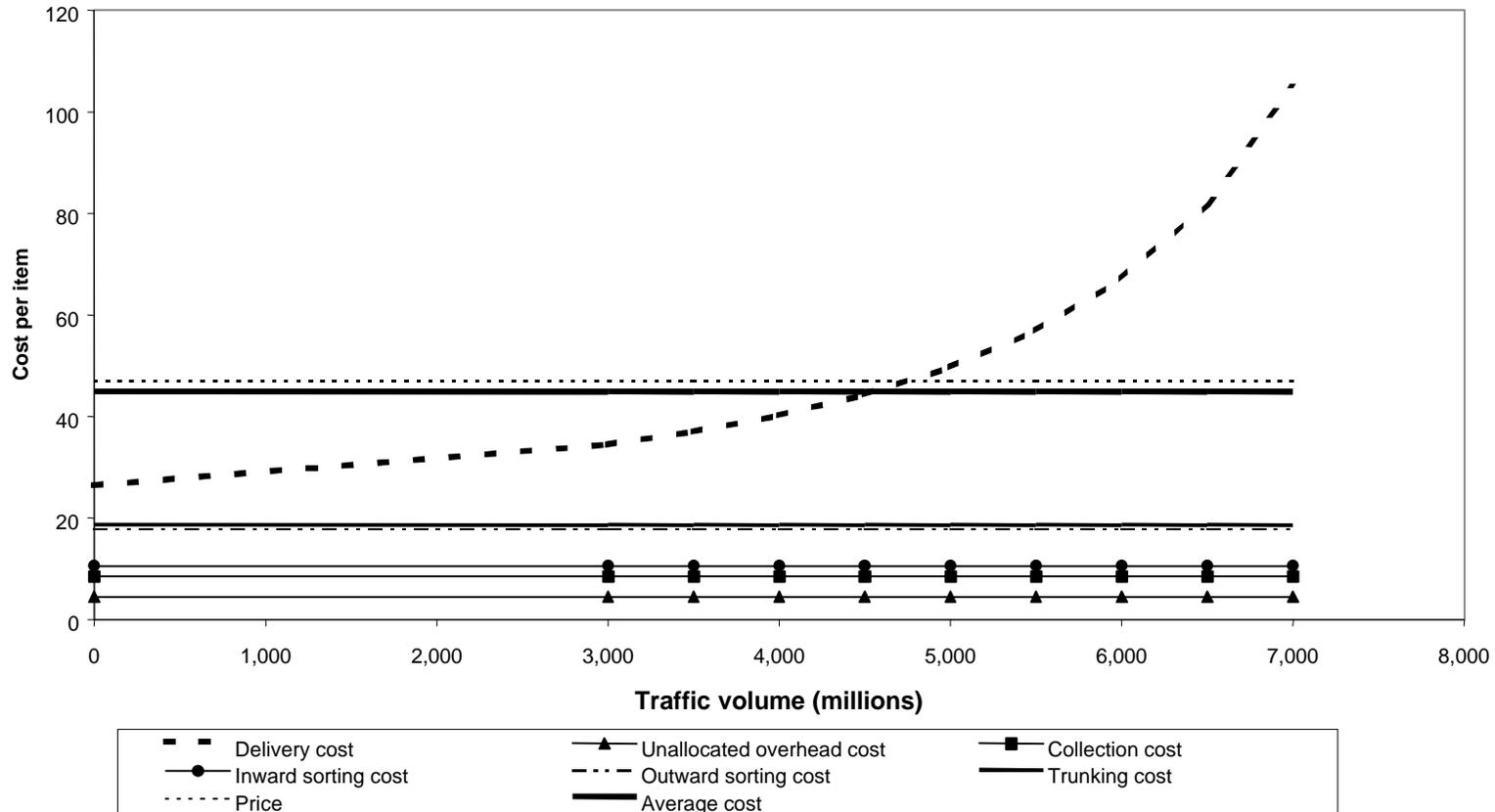


Figure 4.7
Net Avoidable Letter Costs, Country A

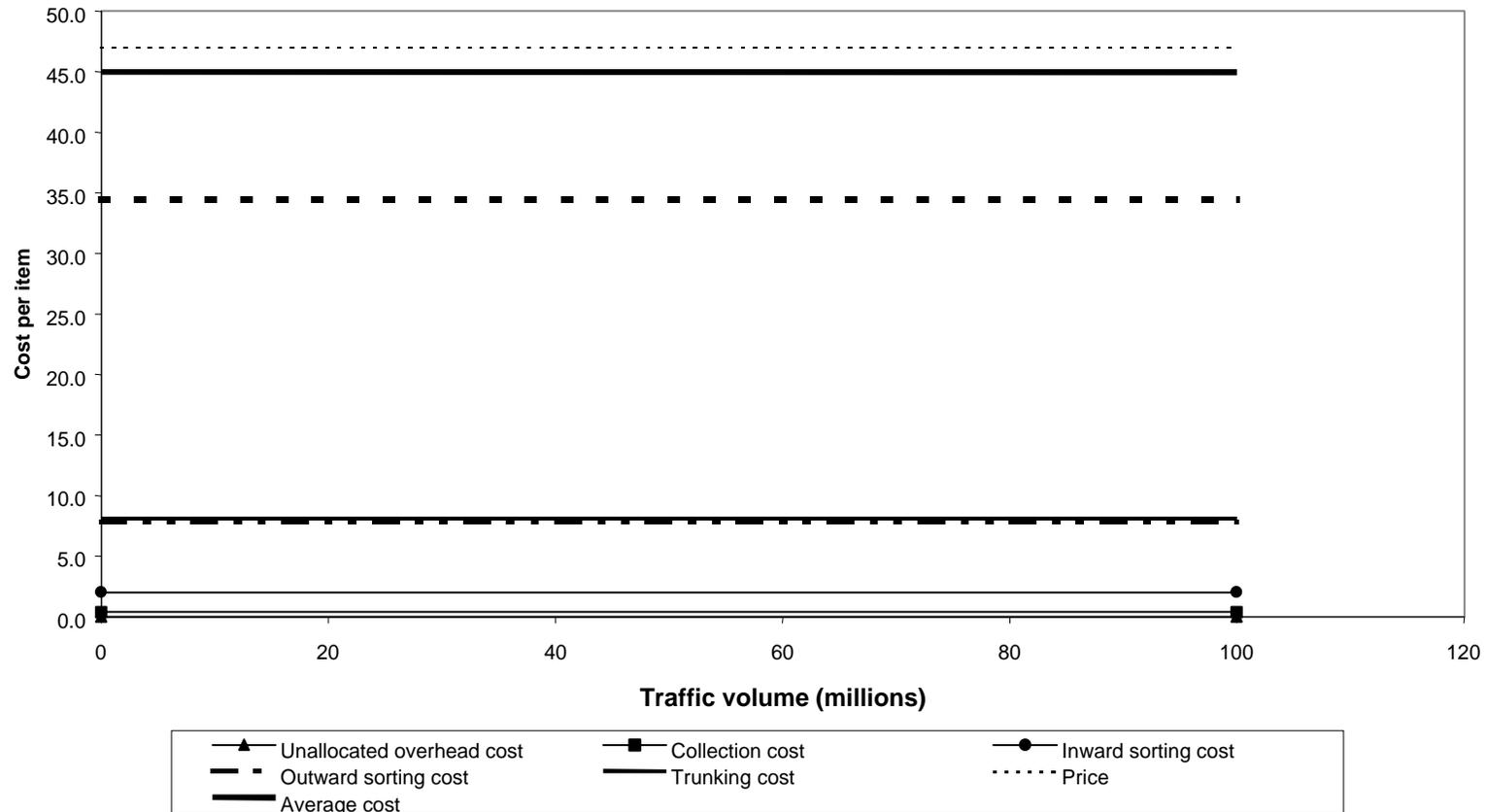


Figure 4.8
Net Avoidable Letter Costs, Country B

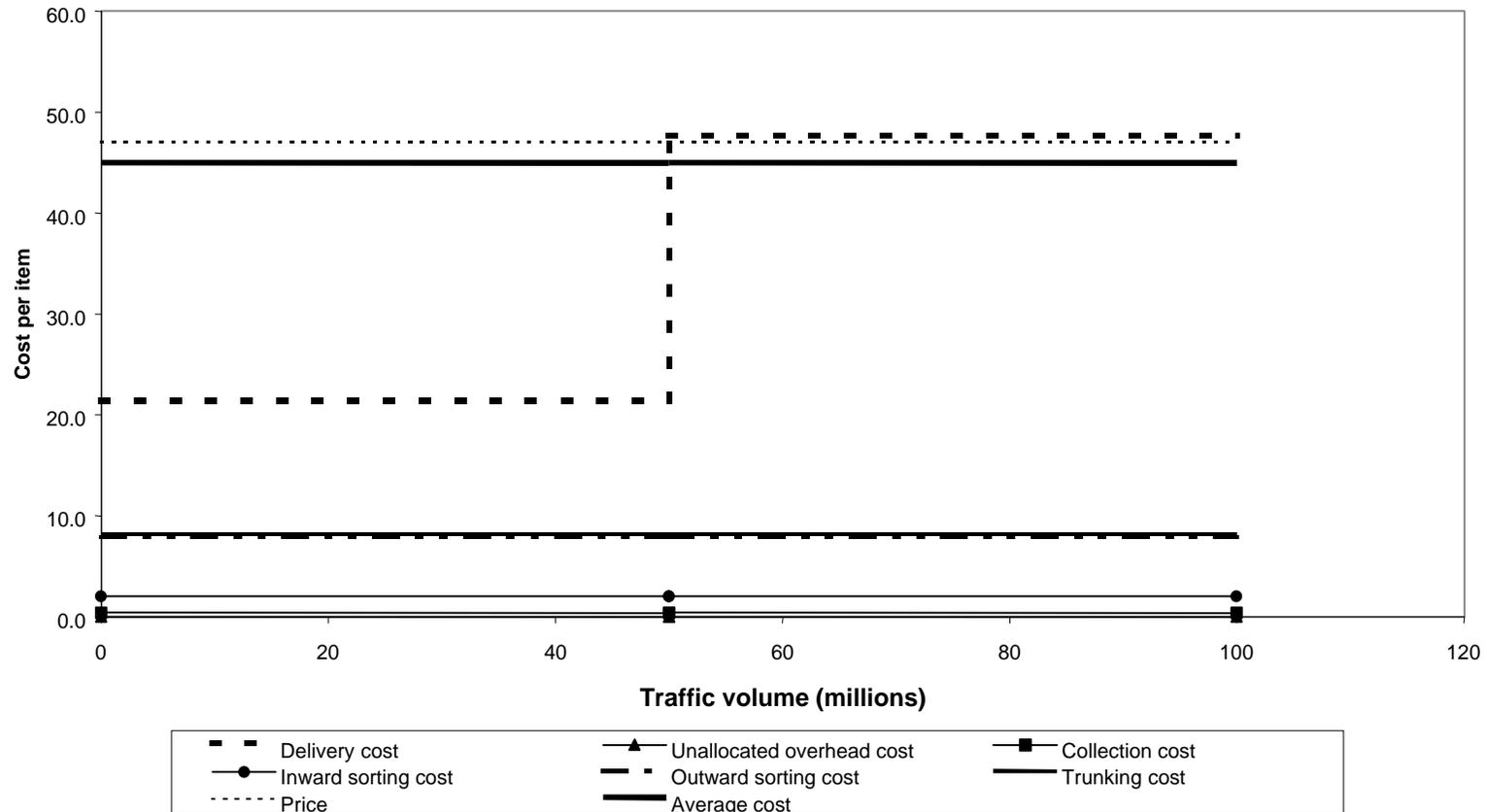
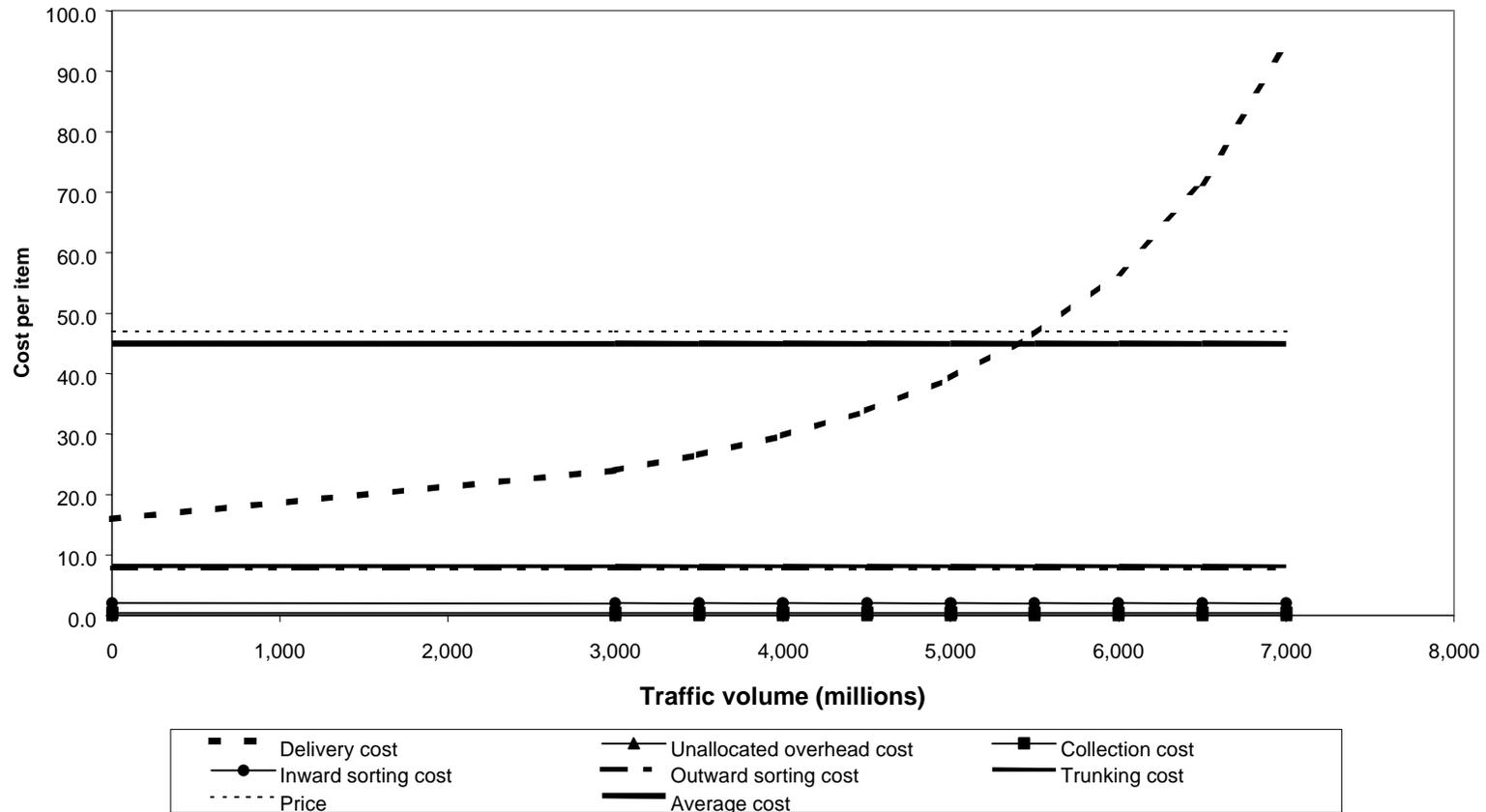


Figure 4.9
Net Avoidable Letter Costs, Country C



5. THE EXTRA BURDENS IMPOSED BY USOS

5.1. Estimates of the Extra Burdens of USOs

This chapter sets out estimates of the extra burdens imposed by USOs for the different Member States based on our methodology and on the data we have obtained from published sources and from postal administrations during the course of this study. The data used to derive these estimates are described in detail in the various country appendices in Appendix C, with estimates provided in the relevant national currency units. We have derived estimates for the most recent year for which data have been available, which generally means either 1996 or 1997. In order to present results on a comparable basis we have converted estimates to 1997 values using the relevant country consumer price index, and then converted these values in 1997 national currency units to ECU using the average national currency/ECU exchange rate for 1997.³⁵

Table 5.1 shows the USO burden estimates for different categories of USO, namely:

- Universal delivery, estimated on a fully-distributed cost (FDC) basis;
- Universal delivery, estimated on a long-run net avoided cost (NAC) basis;
- Saturday delivery;
- Concessions for press and other printed material;
- Free postage on Braille and other material for the blind and partially-sighted; and
- USO costs of unprofitable counters.

In the following sections we consider each of these in turn.

³⁵ Consumer price indices are from OECD *Main Economic Indicators* June 1998, and ECU exchange rates from IMF, *International Financial Statistics* April 1998.

Table 5.1
Estimates of Extra Burdens of USOs at 1997 ECU Price Levels

Member State	Universal delivery		Saturday delivery	Press & other printed matter	Braille & related material	Counters
	FDC basis (million ECU)	NAC basis (million ECU)	(million ECU)	(million ECU)	(million ECU)	(million ECU)
Austria	153	85	included in press and other printed matter	no data	no data	obligation unclear
Belgium	no data	no data	included in press and other printed matter	159	no data	no data
Denmark	19	0	no data	97	5	no data
Finland	5	0	not relevant	not relevant	no data	not relevant
France	455	0	unclear whether is a burden	533	no data	no data
Germany	no data	no data	1170	not relevant	no data	no data
Greece	8	0	not relevant	32	no data	37
Ireland	16	1	not relevant	not relevant	no data	2 ¹
Italy	136		no data	155	no data	25
Luxembourg	A	a	included in press and other printed matter	9	no data	no data
Netherlands	A	a	not significant	not relevant	9	no data
Portugal	19	2	not relevant	12	no data	no data
Spain	no data	no data	not relevant	no data	no data	no data
Sweden	no data	no data	not relevant	not relevant	5	9-23
United Kingdom	323	20	not significant	not relevant	7-17	no data

Notes: See Country Appendices for details of the various estimates

Notes and sources:

USO delivery cost figures: NERA model, except Italy, for which see Appendix D; French universal delivery estimates are averages of the two methods explained in Appendix C.5.6

British universal delivery estimates are averages of the two methods explained in Appendix C.15.8 (we have taken the average in Britain because the method used to split each delivery area into urban and rural components may overestimate the variation between urban and rural delivery costs between areas); a = no data, but expected to be small.

Press concessions: postal administrations

Braille material: British, Danish, Dutch and Swedish postal administrations

Counters: ¹ This includes non-postal transactions and is an overestimate.

5.2. Universal Delivery

5.2.1. Estimates of the extra burden of universal delivery in each country

Table 5.1 provides estimates of the extra burden of USOs for universal delivery, on both a fully-distributed (FDC) basis and on a long-run net avoided cost (NAC) basis for the following Member States: Austria, Denmark, Finland, France, Greece, Ireland, Portugal and the United Kingdom. In the cases of Denmark and Greece we were only able to distinguish between two types of area, urban and rural, but for the others in this group we were supplied with detailed data which enabled us to estimate a delivery cost index. In addition, we present estimates on a FDC basis for Italy.

The degree of disaggregation of data varied from country to country:

- Data for Austria relate to 2,004 separate delivery offices, and therefore represent the most detailed disaggregation we had available;
- The data from Finland relate to 270 delivery offices;
- For France we estimated USO costs based on two alternative delivery cost functions based on data from La Poste, one based on a classification into seven categories, and the other into four categories;
- For Ireland we calculated delivery cost indices from data on labour costs for 50 areas;
- For Italy we had estimates prepared for five different types of traffic (letters, invoices, printed matter similar to letters, printed matter, and parcels) for eight different types of geographical traffic flow;³⁶
- For Portugal CTT Correios supplied data on 430 delivery offices; and
- Royal Mail supplied data for 1,389 delivery offices in the UK. As explained in Appendix C.15, we also split each of these delivery offices into urban and rural components

5.2.2. Universal delivery burdens as a percentage of mail revenue

One reason that delivery burden estimates may vary between Member States is that the countries, and their postal markets, differ considerably in size. Consequently Table 5.2 shows delivery burdens expressed as a proportion of the mail turnover to which they relate.³⁷ This Table shows estimates, on a fully-allocated cost basis, varying between 0.7 per

³⁶ See Appendix D for full details.

³⁷ This turnover, or revenue, is equal to the average price used to estimate USO costs, multiplied by the annual mail volume used to estimate USO costs.

cent and 14.3 per cent of revenue. However the estimates cluster around five per cent of these revenues.

Estimates on a NAC basis are very small. For some countries (Denmark, France and Greece) this partly reflects the fact that we only had very crude, step-function, delivery cost data. However, even for countries which were able to supply much more detail data, the numbers appear small as a percentage of turnover. They partly reflect the assumptions made in each country about the extent to which overhead costs really are fixed, but they are also likely to reflect the fact that, once a national postal network is in operation, the additional costs of serving areas with relatively high delivery costs may not be as high as might have been supposed in the past.

Table 5.2
Universal Delivery: Extra Burden as per cent of Turnover

Member State	FDC basis	NAC basis
Austria	14.3%	8.0%
Belgium	no data	no data
Denmark	2.3%	0.0%
Finland	0.7%	0.0%
France	5.0%	0.0%
Germany	no data	no data
Greece	4.7%	0.0%
Ireland	5.4%	0.3%
Italy	6.7%	
Luxembourg	a	a
Netherlands	a	a
Portugal	4.8%	0.5%
Spain	no data	no data
Sweden	no data	no data
United Kingdom	4.8%	0.3%

a = no data, but expected to be small

5.2.3. Universal delivery USOs in ECU per unit of total traffic

Table 5.3 expresses delivery USOs as a rate per ECU at 1997 prices and exchange rates. These figures are therefore equal to total USO estimates divided by **total** mail volume in each country. The average across these Member States of the USO burden per unit of the total mail carried is around 0.02 ECU per item.

Table 5.3
Universal Delivery USO: Extra Burden per unit of National Mail Delivered

Member State	FDC basis (ECU)	NAC basis (ECU)
Austria	0.0445	0.0248
Belgium	no data	no data
Denmark	0.0127	0.0000
Finland	0.0019	0.0000
France	0.0189	0.0000
Germany	no data	no data
Greece	0.0175	0.0000
Ireland	0.0246	0.0012
Italy	0.01212	
Luxembourg	a	a
Netherlands	a	a
Portugal	0.0179	0.0019
Spain	no data	no data
Sweden	no data	no data
United Kingdom	0.0179	0.0011

a = no data, but expected to be small

5.2.4. Explanations for variations between USO burden estimates

One possibility to explain differences in USO burden estimates between countries is that it reflects the extent to which we have been able to obtain detailed disaggregated data for delivery offices. Table 5.4 shows the relationship between the disaggregation of the data, and the USO cost estimate as a proportion of turnover.

Table 5.4
Relationship Between USO Extra Burden Estimates on a FDC Basis, and the Extent to which Data are Disaggregated

Member State	Delivery cost disaggregation	USO cost estimate as a percentage of turnover
Austria	2004	14.32%
Denmark	2	2.28%
Finland	207	0.67%
France	5	4.98%
Greece	2	4.71%
Ireland	50	5.35%
Italy	40	6.74%
Portugal	430	4.82%
United Kingdom	1389	4.83%

Although the USO burden is highest in Austria, which is the country for which we obtained the most detailed disaggregation of delivery data, there is no obvious relationship between

the extent to which we were able to obtain detailed data, and the resulting USO burden estimates.

One further possible reason why burden estimates may differ from country to country is that different postal administrations have supplied their own estimates of the proportions of their costs which fall into different categories. These proportions differ from country to country, and we trust these differences reflect differences in circumstances between different countries. Nevertheless it is instructive to recalculate postal burden estimates using the same cost proportions across all the countries for which data have been available. Consequently we took the unweighted averages of cost proportions for Austria, Denmark, Finland, France, Greece, Ireland, Italy and the UK, together with the same cost elasticity values for each country. The data used are shown in Table 5.5.

Table 5.5
A Common Set of Cost Proportions and Elasticities

Cost category	Cost proportion (per cent)	Cost elasticity (per cent)
Unallocated costs	12.1	0
Collection	12.1	5
Sorting	22.4	80
Trunking	6.3	30
Delivery	47.1	100

These figures were used to recalculate burdens under both the FDC and NAC basis for Austria, Denmark, Finland, France, Greece, Ireland, Portugal and the UK. Results of this exercise are shown in Table 5.6. Using the averaged data, burden estimates would be lower in Austria, Finland, Ireland and Portugal, higher in Denmark, France and the UK, and virtually unchanged in Greece. We repeat that the appropriate estimates are those calculated using national data, and that this exercise was intended to show sensitivity of results to changed assumptions about cost proportions and elasticities.

A further important reason why burden estimates will vary is the extent to which average price exceeds average cost. If prices are set significantly above average costs then burden estimates will be lower than if price is at or close to average costs. We undertook a sensitivity analysis of this factor by comparing the Member States where USO burdens comprise the highest (Austria) and lowest (Finland) proportions of turnover.

If price in Austria were to be set at the same proportional mark-up over average costs as they are in Finland, then the FDC extra burden in Austria would be 1559 million schillings rather than 2115 million, a fall of 26 per cent.

If prices in Finland were to be set at the same proportional mark-up over average costs as we have assumed they are in Austria, then the FDC extra burden in Finland would be 247 million FMK rather than 29 million FMK, an eight-fold increase.³⁸

Table 5.6
Sensitivity of Burden Estimates to Cost Assumptions

Country	FDC basis (million ECU)		NAC basis (million ECU)	
	National data	Averaged data	National data	Averaged data
Austria	153	139.5	85	62.1
Denmark	19	20.8	0	0
Finland	5	3.8	0	0
France ¹	455	545.9	0	16.1
Greece	8	7.9	0	0
Ireland	16	12.6	0.8	0
Portugal	19	13.1	2	1.07
United Kingdom ²	323	422	20	49

¹ French figures are an average of the results of the two letter data sets.

² UK figures are an average of the results of the two data sets with and without the urban/rural split.

5.2.5. Universal benefits of postal service

The Terms of Reference of this study require considerations of benefits of universal service as well as burdens, and in section 3.1.4 we indicate that we believe that such benefits, under the term "ubiquity", are relevant. However we have not been able to provide any numerical estimates of these benefits. In principle they might be measured by the extent that a postal administration can charge a higher average price for all traffic because users know they can access all addresses in the country on a daily basis and with specified quality of service. In practice this would be difficult to estimate, though we believe that users do derive some benefits from ubiquity. For example, the Direct Marketing Association expressed the view to us that: "Large users want a national service, comprehensive coverage ensures they can communicate with all their existing and potential customers (therefore) it is inconceivable that any PTT will stop servicing a few areas to save money Any PTT with a national coverage and infrastructure in place has a tremendous commercial and business advantage."³⁹

³⁸ Neither of these calculations takes into account the impact of price changes on traffic volumes, though we do not expect this to have a major impact on the overall impressions provided by this sensitivity test.

³⁹ Letter of 11th September 1998 to NERA from the Direct Marketing Association.

5.3. Saturday Delivery

As indicated in Chapter 2,⁴⁰ the situation with regard to Saturday delivery varies from country to country, in the following ways:

- No Saturday delivery: Finland, Greece, Ireland, Portugal, Spain, Sweden;
- Saturday delivery of newspapers only: Austria, Belgium, Luxembourg;
- Saturday delivery of mail: Denmark,⁴¹ France, Germany, Italy, and The Netherlands; and
- Limited Saturday deliveries: the United Kingdom.

A USO burden from Saturday delivery arises if a postal administration delivers on Saturday but would not choose to do so for commercial reasons. At the meeting in Brussels on June 25th we invited those postal administrations which believe that Saturday delivery imposes a burden on them to contact us with further information. We then followed this up with a letter to all postal administrations with Saturday delivery.

The first issue is whether in the country concerned private parcel and express carriers deliver on Saturdays and, if so, whether they charge a premium. If the private carriers indeed deliver on Saturdays without a premium, the implication is that the postal administration may need to do so too in order to be competitive. In this case no burden is entailed because Saturday delivery represents a commercial decision by the administration. If the private sector delivers on Saturdays with a premium, and if the postal administration is not permitted to charge a premium because of a USO requiring a uniform price, then in NERA's judgement the administration suffers a burden.

Estimating such a burden involves analysing the costs entailed. In addition, assumptions must be made about changes to the volume and value of traffic that would occur if Saturday delivery was discontinued and the extent to which costs could be adjusted to the new pattern of traffic. Daily newspapers are strongly time-sensitive but most other mail traffic is less so. Stopping Saturday delivery could result in the loss of considerable newspaper traffic but only a little of other forms of business.

⁴⁰ See Table 2.5.

⁴¹ Letters but not parcels.

It is likely that the elimination of Saturday delivery would save a significant part, though not all, the associated costs. The volume of mail previously carried on Saturday would have to be carried on Mondays if the quality of service measured by end-to-end delivery on D+1 were to be maintained. If the volume of mail on Monday could not be carried by the existing staff, additional hours would be needed. On the other hand, Saturday duties may entail overtime rates of working, so transferring work to Monday could be more economical.

In our questionnaire to the administrations which deliver on Saturdays we sought to elicit replies to two main questions:

- does each administration consider that Saturday deliveries are a burden? and
- if so, as a simplification, could that burden be roughly estimated as the cost of one complete delivery divided by the total number of deliveries?⁴²

Below, we give an account of the issues raised by those administrations who consider that Saturday delivery is indeed part of their USO burden.

5.3.1. Belgium

La Poste, considers that Saturday delivery of newspapers, as required by the management contract (contrat de gestion), imposes a burden. However, La Poste confirmed that private operators deliver on Saturdays without charging a premium tariff. Further, they stated that if La Poste did not deliver newspapers on Saturdays this traffic could be taken by other operators who might then also take over the distribution of newspapers for the remainder of the week and possibly other forms of correspondence such as unaddressed mail as well. La Poste quoted the cost of Saturday delivery of newspapers as being a substantial figure not least because of the higher cost of labour on Saturdays, but pointed out that the figure does not represent the net amount that would be saved if Saturday delivery of mail were stopped.

Given that private operators deliver newspapers on Saturdays, it is arguable that even without a USO La Poste would do so too for competitive reasons, though possibly at higher tariffs. In 1997 La Poste received a payment from the state of BF 6, 431 million in respect of services provide by its postal business unit. This is intended to cover the costs of all government services as well as newspaper delivery on Saturday.

NERA concludes that it is uncertain whether the Saturday delivery of newspapers by La Poste constitutes a USO burden. A burden may arise from the control of prices rather than from Saturday delivery as such. In the absence of data on the costs of delivery by La Poste generally and on Saturdays in particular, NERA has not attempted to estimate the burden, if any, of La Poste's Saturday delivery of newspapers.

⁴² For example, if an administration does six deliveries per week, the cost of Saturday delivery would be estimated roughly as one sixth of total direct delivery costs.

5.3.2. France

La Poste, France, confirmed that Saturday delivery is part of their USO but did not state whether in their view it constitutes a burden. Nor did they state whether private parcel and express carriers generally provide Saturday delivery. They informed us that they have no estimates of costs specific to Saturday delivery.

If the private sector does not normally offer Saturday deliveries, we could consider Saturday delivery to be a burden to La Poste. If we then make the simplifying assumption that the same volume of mail could be delivered in five days as previously was delivered in six, we can make a simple estimate based on one sixth of total delivery costs, namely FFr 4.1 billion. Clearly considerably more information is required to take account of potential changes in traffic volumes and the extent to which delivery costs on Mondays would increase in relation to the volume of traffic transferred to that day.

In the absence of information on whether Saturday delivery by the private sector is normal in France, NERA is unclear whether Saturday delivery by La Poste constitutes a burden.

5.3.3. Germany

Deutsche Post AG (DP AG) provides Saturday delivery as part of its USO. We were informed in their questionnaire response that private parcel and express carriers do not generally provide Saturday deliveries, and at interview we were told that any carriers that do so charge high supplements. Thus, we can conclude that DP AG is not under competitive market pressure to provide Saturday deliveries and we conclude that there is a USO burden in doing so.

DP AG considers that if Saturday deliveries were stopped there would be slight reductions in the volume of traffic, but did not provide an estimate. On potential savings, DP AG put these at 15 per cent of total annual delivery costs plus savings upstream in sorting and transport. The 1996 annual report of DP AG provides revenue by various types of traffic, but no break-out of costs by type of traffic is given. NERA has therefore made the simplifying assumption that the costs for each type of traffic are the same as the revenue. DP AG gives delivery as 69.4 per cent of its costs. Applying this percentage to the revenue for letters and parcels combined, we have a delivery cost of DM 15.5 billion. Taking 15 per cent of this as the potential saving if Saturday deliveries were stopped and ignoring additional savings upstream and losses of revenue from possible reductions in traffic, we have an initial estimate of the USO burden of DM 2.3 billion.

Clearly it would be possible to refine this figure. At the Commission's workshop in Brussels on 25 June 1998, DP AG said that the total parcel USO burden had been calculated and would be put into the public domain in due course. At the time of writing, this information has not been made available to NERA and we do not have the means to refine the initial estimate.

5.3.4. Italy

The Italian Ministry believes that Saturday delivery imposes a burden on Poste Italiane, but are not in a position to supply data on the changes in postal costs and revenues that would follow if Saturday delivery were to be discontinued

5.3.5. Luxembourg

In Luxembourg the Saturday delivery obligation relates to daily newspapers. Delivery to post boxes also occurs. P&T Luxembourg informed NERA that private parcel and express carriers generally do not provide Saturday delivery. They consider that there would be a saving if Saturday delivery were stopped and that Saturday delivery corresponds to about one twelfth of total delivery costs.

NERA considers that the P&T might lose newspaper traffic to private carriers if Saturday delivery of newspapers was stopped. (This point was made to us by the Belgian Poste.) Therefore, if the P&T sets tariffs for newspaper delivery that allow for the cost of Saturday delivery there is no burden. If current tariffs are too low and are held down by political or other pressure, the resulting burden is not specific to Saturday delivery as such. At present NERA is unable to attribute a USO burden to the delivery, specifically on Saturday, of newspapers, other than that which is already included in EPT's estimate of the overall cost of the concession for press and other printed matter discussed in section 5.4 below.

5.3.6. The Netherlands

With regard to sixth day delivery, TPG noted that they did not consider stopping six day deliveries, and that "from a commercial point-of-view, even a seven day's delivery could be interesting". TPG regard the cost of Saturday delivery as one sixth of total delivery costs: however, of all the days of the week it is Monday which has the lowest mail volumes.

5.3.7. The UK

The UK Post Office indicated that they do not believe that Saturday delivery imposes an additional USO burden which should be considered in the present study.

Further views on the matter of Saturday delivery received after completion of the Draft Final Report will be incorporated at a later stage, and we are not at present including any burden estimates for Saturday delivery in the figures in Table 5.1.

5.4. Concessions for Press and Other Printed Matter

As indicated in Table 2.9, concessions for press and/or other printed matter are provided in a number of Member States, namely Austria, Belgium, Denmark, France, Greece, Italy, Luxembourg, Portugal and Spain.

Appendix B indicates a method for estimating the net burdens incurred by postal administrations as a result of carrying traffics at zero or subsidised prices. This method requires data on traffic volumes of the subsidised traffics, information on the extent to which the prices charged are below commercial prices, and evidence on demand elasticities.

In practice, data of this type have not been available in the present study, but some of the postal administrations which provide these concessions do receive explicit subsidies for performing these tasks, and/or have made their own estimates. These are the figures shown in Table 5.1.

As noted above in 5.3.1, La Poste in Belgium received a payment of BF 6,431 million in 1997 from the state in respect of a postal payment for newspapers and public service traffic carried free or at rates below costs.⁴³

Post Denmark is obliged by Section 14 of the Act on Postal Business to send and deliver newspapers, weekly and monthly magazines, as well as periodicals approved by the state, at low rates which are insufficient to cover Post Denmark's related direct cost. The resulting negative gross profit margin is computed in accordance with the provisions of the Accounting Regulation, and covered by a state subsidy. In 1996 this subsidy amounted to DKK 503 million. In addition, the deficit on this business due to uncovered overheads may be covered by a cross-subsidy from the monopoly area. In 1996 this cross-subsidy amounted to DKK 203 million.⁴⁴ These total subsidies of DKK 706 million are converted to 1997 ECU and shown in Table 5.1.

La Poste in France estimate that the cost of concessionary tariffs for newspapers etc cost approximately FF 7 billion a year. Of this one-half is borne by La Poste.⁴⁵

In 1996 EL.TA in Greece received a payment of 8,898 million drachmas from the Ministry for Press in respect of concessionary rates for press material.⁴⁶

EPT in Luxembourg is compensated for concessionary tariffs by a reduction in its tax liability, though it is not clear to us how far this represents a full compensation. EPT have produced their own estimates which give the cost of the concession to newspapers and other press material in 1997 as LuF 334.7 million, while the cost of concessions to non-profit-making organisations in 1997 was estimated by EPT to be LuF 40 million.⁴⁷

CTT Correios in Portugal also receive payments for material carried at concessionary rates. CTT have estimated the losses at 2,318 million Escudos in 1997.

⁴³ See Section C.2.7.

⁴⁴ Post Denmark *Annual Report and Accounts 1996* p.41.

⁴⁵ See Section C.5.5.

⁴⁶ See Section C.7.2.

⁴⁷ See Section C.10.

5.5. Braille and Related Material

All countries deliver material for the blind and partially sighted without charge. Estimates of the burden of this concession were provided by postal administrations in Denmark, The Netherlands, Sweden and the UK. In Denmark the cost of the concession is estimated at DKK 35 million a year, in The Netherlands at DF 20 million a year, in Sweden at SK 44 million, and in the United Kingdom at between £5 million and £12 million a year.

These figures represent, respectively, 0.6 per cent of Danish letter mail revenue (ie excluding parcels, newspapers and unaddressed mail), 0.6 per cent of Dutch domestic mail turnover (ie excluding direct mail and international mail), 0.3 per cent of Sweden Post Letters' operating revenue, and between 0.1 and 0.25 per cent of Royal Mail's revenue. In the absence of information from other Member States, we would expect these proportions to give an approximate indication of the range of the burdens of these concessions in relation to national letter mail turnover in other countries.

5.6. Post Office Counters

In section 2.4 we discussed the practical difficulties that are met in first defining USO burdens in counter networks generally, and secondly in measuring the burdens once they have been defined. In this section we discuss the possible burdens of the counter networks in those countries that provided data.

5.6.1. Greece

EL.TA has 1,036 post offices and in addition there are 260 agency counters, which are generally smaller and in rural areas. EL.TA estimates that there are 762 unprofitable post offices in Greece, and that the average annual loss from each of these is 20 million drachmas. This gives a total loss from unprofitable counters of 15.3 billion drachmas (ECU47m). However, not all of these losses are associated with postal business, which accounts for 79 per cent of mark-ups. We can therefore estimate the postal burden on EL.TA's counters as ECU 37m.

5.6.2. Ireland

As described in Appendix C, a viability plan in 1990/91 considered a number of cost reduction measures. This included closing the 554 most unprofitable counter offices⁴⁸ which was estimated as likely to lead to an annual saving of Ir£1.8 million each year, once transitional costs had been incurred in 1990 and 1991. In the event, political opposition led to abandonment of this part of the plan.

⁴⁸ The total number of sub-offices in 1990 was 1951. Of the 554 offices proposed for closure, 28 were in Dublin, 48 in other towns, and the rest were rural.

One view might be that this saving, updated for inflation, could be described as a USO burden upon An Post. However, the post offices in question handle many other transactions in addition to those that are strictly postal. Further, as we pointed out in section 2.4, if government correctly compensates the postal administration for governmental transactions in total, cross-subsidy between urban and rural post offices may occur but there is no burden on the administration. If government does not fully compensate An Post for the cost of governmental transactions and if at the same time An Post is prevented from reducing the network, a burden arises. In the light of these variables we conclude that the figure of Ir£1.8m at 1990/91 prices (ECU 3 million at 1997 prices) may represent a burden of which some part only can be attributed to postal as opposed to governmental transactions.

5.6.3. Italy

Appendix D describes how Poste Italiane undertook calculations of USO burdens resulting from small post offices which are kept open for reasons of social consideration in spite of deficit operations. Poste Italiane received a transfer payment from the Ministry to cover the USO burdens of these peripheral post offices. Of the total estimated burden of Lit 231 billion (ECU 118 m) attributed to the USO, Lit 48.6 billion (ECU 25m) was attributed to the postal USO.

5.6.4. Portugal

CTT Correios are in the process of estimating the losses on their unprofitable counters. They regard the maintenance of the universal network of counters as their most costly burden.

5.6.5. Sweden

Sweden Post regards its obligation to provide universal payment services as its most burdensome obligation. In 1997, the Swedish Government paid Sweden Post 200m SEK (ECU 17.5m) for providing the counter service. Sweden Post claims — and we understand that Government estimates also show — that this sum is significantly less than the "cost" of providing uneconomic counter services. The Swedish Government is concerned about the costs of these obligations and has set up a special investigation to explore different ways in which payment services might be provided in future.

Two approaches to measuring the costs of this obligation have been undertaken. The first involves estimating the losses made on counters offices where there is no bank in the surrounding area. This gives a figure of around SEK400m (ECU 46m). The second approach involves determining how many counter operations a commercial operator might continue to maintain and then calculating the net cost of the additional counter offices that Sweden Post is currently obliged to provide. We understand this gives a much higher cost of SEK 800m-1bn (ECU 91-114m).

In the present context it is not obvious that either figure estimates the postal USO burden. Banking operations do not form part of universal service as defined by chapter 2 of the

postal directive.⁴⁹ This being so, the maintenance of post office counters for *banking* purposes may well be a burden to Sweden Post, but that is not a burden that flows from a postal USO. As shown in the section on Italy above, only a minority of counter costs — one fifth in the case of Poste Italiane — relate to postal activities . If this ratio applies also in Swedish counters, only one fifth of the cost of counters can be considered a postal USO, namely ECU9-23million.

⁴⁹ Directive 97/67/EC of 15 December 1997, on the common rules for the development of the internal market of Community postal services and the improvement of quality of service. OJ L15/14, 21 January 1998.

6. FINANCING USO BURDENS

6.1. Introduction

The previous chapter considered the various types of extra burden imposed on postal operators in the European Union because of USOs. In this chapter we consider how extra burdens should be financed. However we concentrate on the extra burdens of universal service (including, where appropriate extra burdens of Saturday delivery and of providing unprofitable counter services). This is because, if the state requires a postal operator to provide concessionary postal rates for press and other published material, it seems appropriate that the state provide a direct subsidy for this. Indeed this already happens in many cases.⁵⁰ In addition, if the delivery of material to the blind and partially-sighted is to be compensated, then the appropriate mechanism would be via the state's social welfare budgets.⁵¹

This chapter therefore concentrates on the financing of the extra burdens of universal service.

6.2. Financing Extra Burdens of Universal Service: the Options

6.2.1. Main forms of finance

There are a number of options available to finance postal USO burdens. Directive 97/67/EC explicitly sets out two:

1. reserving monopoly provision of particular services, and using the profits from these to support the extra burdens imposed by USOs; and
2. setting up a universal service fund (USF) to which postal operators contribute.

Thus the Directive specifies that USOs may be financed either through reserving services to the universal service provider (Article 7, Sections 1 and 2) or through payments to a compensation fund administered by an independent body (Article 9).

A further option is that general taxes be used by Member States, who can raise taxes to finance all services of a general interest, including postal USOs.

⁵⁰ Ideally such a subsidy should make the recipient neither better-off nor worse-off financially than if the concession were not available. The conditions for this are described in Appendix B.

⁵¹ Though no postal operator we interviewed indicated that they **did** wish to be compensated for this obligation.

6.2.2. Variants and alternatives

Franchising of USO services, including delivery, is also a possibility. The option of franchising can be seen as a way of reducing extra USO burdens by reducing the cost of their provision. Under franchising an operator undertakes to undertake specified activities which form part of the USO, but which the main operator is unwilling to do without subsidy. Normally franchisers would be chosen by a process of competitive bidding, in which the activity is awarded either to:

- The lowest bidder who is able to satisfy specified minimum quality standards; or
- The bidder who offers what is judged to be the best combination of price and quality standards.

As in the case of British rail passenger franchises, bidders may require subsidy or, if they have lower costs than the existing operator, they may even be prepared to offer to pay for the right to provide the service.

Franchising may therefore be seen as a financing option which is intended to reduce the USO burden, though if subsidies are still required they will still have to be funded. Franchising is already widely used in postal markets for agency counters.

A further possibility is to require all operators to provide universal service. This might not necessarily cover the whole country, but might relate to provision of a range of services in a particular area of the country. However, if USOs impose burdens, it is difficult to see how imposing burdens more widely might be justified. Requiring new operators to provide aspects of universal service might also act as an entry barrier. It may also be difficult to enforce: unlike the situation in telecoms, where it is impossible to access a local call network without that network operator's approval, a postal operator has no problems in accessing the national operator's postal network because he can simply post mail into the national system at any point.

The final possibility to reduce the burden of USOs on the USO provider would be to reduce the scope of the USO. However, this is not an option in practice and so is not considered further in this report.

6.3. Criteria for Appropriate Financing Method

An appropriate financing scheme must satisfy certain principles set out by the Directive and meet certain requirements dictated by economic and practical arguments. These are explained below and include:⁵²

- objectivity and transparency;
- national treatment;
- proportionality;
- efficiency; and
- practicability.

6.3.1. Transparency

The principles and functioning of funding schemes must be objective and transparent. Market participants should be in a position to understand the workings of such schemes without difficulty. Transparency will often mean that there should be transparency in the accounting for reserved and non-reserved services. Furthermore, any information that is required should be capable of being independently verified.

6.3.2. National Treatment Principle

The principle of *national treatment* requires that “any discrimination on the grounds of nationality shall be prohibited” (Article 6 of the EC Treaty). Therefore other EU postal administrations or other operators from any member state would be allowed to apply or bid for a franchise or licence.

6.3.3. Proportionality

The concept of proportionality requires that action by the Member States must be necessary to attain the particular objective and *the measure must be appropriate for the attainment of the objective*. In this context, for example, distortions to competition from the funding arrangements would be allowed only if this was necessary to satisfy the provision of the universal service obligations.

⁵² See Wissenschaftliches Institut für Kommunikationsdienste GmbH (1997), *Costing and Financing Universal Service Obligations in a Competitive Telecommunications Environment in the European Union*, Study for DG XIII of the European Commission, October. They point out that unless appropriately specified, specific universal service funding schemes carry with them a number of potential risks, including damaging effects on economic efficiency, distortions of incentives in industry, discrimination and failure to satisfy the proportionality and practicability constraints.

6.3.4. Efficiency

In addition to the principles set out in the Directive, funding schemes should also satisfy a range of criteria dictated by economic arguments, including minimising allocative efficiency losses and distortions, avoiding discrimination and maintaining incentives for the cost-efficient provision of services and for efficient market entry. The chosen scheme must also be able to generate the necessary funds on a continuous basis. In addition, the scheme should not be capable of being undermined through the actions of new entrants.

Allocative efficiency losses occur when the service provider passes on the financial burden of funding the USOs by means of price increases to all customers, not just those who impose the costs. According to the principles of welfare economics, these distortions should be kept to a minimum, (i.e. prices should be cost-based). However, as shown in chapter 2, most Member States currently require that postal tariffs be uniform as well as "affordable", and so such distortions already exist.

Avoiding discrimination implies ensuring competitive neutrality among operators. This means that the funding solution would not create an unfair competitive advantage for one operator against another.⁵³

The method of funding should promote cost-efficient provision of USO services. Taken further this criterion could be interpreted as keeping to a minimum the reserved area, as competition over a wide range of services should help promote efficiency.

6.3.5. Practicability

Finally, funding schemes must be practicable in that they are not unduly complex, and do not require undue amounts of information for their administration or impose undue administrative costs on either operators or on the National Regulatory Authority (NRA). In addition, it should be kept in mind that a funding scheme which depends on contributions from market players requires a fair and acceptable method of fixing contributions. A final consideration concerns the political acceptability of a given scheme.

6.4. Financing Methods

6.4.1. Reserved services

Universal service obligations of postal operators are typically funded through cross-subsidies within a reserved area of services. These cross-subsidies are usually justified by

⁵³ Neutrality across service types and different technologies should also be maintained so as not to distort the choice of services or technologies. These considerations are important in telecommunications but carry less relevance in the postal sector where fewer services are provided, typically using a common technology.

policy makers in terms of the wider social benefits, though in some cases they might also be justified on efficiency grounds related to the theory of public goods.⁵⁴

In terms of the above criteria, reserved areas are clearly defined in terms of services covered and applicable time scale, and hence are transparent to all market participants. There may be some debate as to whether this option complies with the principle of proportionality. On a practical level, this option provides an administratively simple way of funding universal service obligations.

The main difficulty with this option is in deciding the scope of the reserved area. In principle, the reserved area should give the minimum protection required to enable the operator to earn a normal rate of return while still fulfilling the universal service obligations. In practice, the optimal limits to such a reserved area in a future liberalised environment can only be determined through detailed modelling work examining the implications of different liberalisation scenarios. This work is being carried out in the other studies on the postal sector being undertaken for DGXIII in 1998.

6.4.2. Universal Service Fund (USF)

Cross subsidies risk breaking down if the profits used to fund the extra burdens were eroded by competition. In such cases, alternative methods of funding would be required if USO burdens were significant.

A Universal Service Fund (USF) constitutes a general levy on all industry operators. Contributions may be set according to the number of uneconomic customers served or the volume of uneconomic traffic carried by each operator.⁵⁵

A USF can satisfy transparency as long as the rules which define contributions are clearly spelt out and are not subject to unforeseen changes over time. A USF also satisfies the principles of national treatment as it affords like treatment to operators of any nationality. This scheme also seems an appropriate measure for the financing of the USO and, hence, could be said to fulfil the principle of proportionality. The tax base would not be as wide as, say, a general tax and hence, the tax distortions arising would be greater.⁵⁶ Another

⁵⁴ The theory of pure public goods deals with goods and services which once provided, can be consumed equally by all. The problem is that it will be impossible to prevent people consuming these goods, so that individuals have an incentive to "free-ride" by understating their willingness-to-pay. Hence these goods will not be provided through normal market mechanisms. Yarrow argues that cross-subsidising payphones and emergency telephone services may be justified because of the public good nature of these services, though he also suggests other ways in which such services could be funded (such as by local authorities) - see G K Yarrow, "Dealing with Social Obligations in Telecoms" in M E Beesley (ed.), *Regulating Utilities: A Time for Change?*, Institute of Economic Affairs, 1996.

⁵⁵ A Universal Service Fund has been adopted in telecommunications in Australia. The basis for sharing the costs of the USO among carriers is each carrier's share of the interconnect time between those carriers' trunk and international networks and all local access networks.

⁵⁶ Taxes cause a distortion from economically - efficient prices. Other things equal, the welfare cost of this distortion rises proportionately faster than the tax rate, so that it would be more advantageous to spread the burden across a wider range of taxed commodities and services.

advantage of this approach is that it does not have to entail discrimination among operators unless the distribution of costs among operators is set in a particularly distortionary manner. The implementation of a USF is practicable provided that contributions and possible exemptions are determined in a satisfactory manner. (This issue is discussed in Section 6.5 below). Both aims of an acceptable administrative burden and political expediency are met.

However, if a USF is available to reimburse the incumbent's extra burden, the incumbent has a perverse incentive - the higher the estimated burden, the higher the payments from the USF.

6.4.3. General taxes

Another option is to provide direct Government subsidies for the uneconomic services. As the provision of the USO could be seen to be beneficial to society as a whole, a strong case could be made for transferring the costs of this provision directly to Government. While this option has the merit of spreading the tax base most widely, it may prove to be a politically contentious. It would have to be considered carefully against the background of the prevailing political and institutional framework in a given country. However, this option has the advantage of being the simplest one to administer, with no discrimination taking place.

One serious disadvantage may be that there would be few incentives to provide postal service efficiently if the state simply compensates the postal administration for any losses made. Compensation would need to be based on transparent estimates of the burdens incurred specifically for universal service obligations incurred by an efficient operator. Defining an efficient operator is not easy in the absence of competition for the uneconomic services.

6.4.4. The role of franchising

USO services may be contracted or franchised to another operator through a process of competitive tendering or auctioning to provide USO services.

Franchising has the advantage of promoting the cost-efficient provision of USO services and will also promote efficient market entry. The operator with the lowest bid will also be the most cost-efficient. If the incumbent possesses some cost advantages through economies of scale and scope, and if this causes him to underbid competitors, the advantages of scope and scale are passed on to society. In the postal market, these scope and scale advantages are not expected to be large since the main cost of providing services to USO customers will be wage costs. Hence, unlike the case with telecoms, the incumbent will not have significant sunk capital infrastructure in unprofitable areas.

While the national operator's bid may be the lowest because of scope and scale advantages, nevertheless the national operator may be less cost-efficient in the provision of the services. However an appropriate time frame for the franchise contract can alleviate this problem. In

a second auction for the franchising contract, when the existing capital infrastructure to provide the USO service has been written off to a greater degree, operating costs will feature more prominently in the bid and a new entrant with lower operating costs might win the contract.

For the franchising approach, a key issue is its practicability. This depends on the ease with which a well-defined and enforceable franchise contract for universal service components can be devised, and on the likelihood that there will be operators other than the national operator willing to provide the service. The boundaries of the service to be franchised would require careful definition, and clear arrangements for access to different operators' sorting, transport and delivery networks would be required. If it is difficult to identify loss-making traffics in advance, this increases the risk for franchisees that the package of services they contract to provide will cost more than they expect - but they might alternatively find that it costs less than they expected. Ultimately, the returns achieved by different franchisers helps to identify more clearly where different USO burdens are incurred.⁵⁷

6.4.5. Imposing USOs on all market participants

As indicated above, imposing USOs on all market participants may be ineffective. New entrants' operations may not cover rural or other unprofitable areas, or it may not be possible to force new participants to market their services effectively in these areas. Also, the obligations must be in relation to the service provided. Hence, some operators can claim their right to limit their provision to a particular service under normal commercial freedom.

6.5. Basis for Assessing Contributions to USO Costs

For industry levies like a Universal Service Fund (USF), the USO burden has first to be identified. A major role of the independent body responsible for the USF will therefore be the estimation of the changing extra burdens of the USO in a liberalised environment. This is likely to be a costly process, and one which will require detailed access to the USO provider's cost and revenue information.

Once the cost of the extra burdens imposed by USOs have been identified, their division between the various authorised operators needs to be considered. The bases we consider are:

- traffic carried by the different authorised operators; and
- revenue earned by the different authorised operators.

⁵⁷ This has been a feature of franchising in the market for local bus services in Great Britain. Before deregulation of the market, the industry as a whole was unprofitable, but there were thought to be extensive cross-subsidies within the system which no-one had been able to identify. Only when operators could choose which services to operate commercially did it become clear which individual services and types of service required subsidy through a competitive tendering system.

Profits would not provide a suitable basis for the tax, because in practice, firms can artificially reallocate costs to business areas through creative accounting. This would imply the need for detailed scrutiny by the national regulatory body and, hence, would increase costs. Even then, there may be little the national regulatory authority can do to change outcomes.

6.5.1. Traffic volumes

The main problem of assessing contributions to funding the USO based on traffic volumes concerns data availability. In the postal sector, data on all traffic flows are not collected but, instead, are estimated based on statistical sampling. In addition, these figures are not currently subject to auditing. These limitations suggest that revenues may provide a more suitable basis for assessing contributions.

6.5.2. Revenues

Various revenue measures have been discussed in WIK (1997) in the context of telecommunications.

Revenue-based measures have a number of advantages and generally satisfy the criteria discussed above, especially market neutrality, non-discrimination and practicability. The advantage with revenue-based measures is that revenue reporting requirements exist in practice and these figures are typically audited or are readily capable of being audited.

In the context of revenue measures, two further questions arise, namely those related to the customers and services to be included in the contribution base. WIK (1997) makes a case for excluding those revenues which accrue from "uneconomic" customers in order for the incumbent to be placed on a par with other competitive operators who choose only to supply "economic" customers. In addition, WIK net off payments between operators (for use of each others networks) in order to arrive at an appropriate revenue base - termed net revenues. A similar approach should be adopted for postal services as this avoids any double counting and puts operators on an equal footing. However, such a system might in practice be unwieldy and lacking in transparency. As shown by NERA's questionnaires, administrations' cost structures differ widely. The practical difficulties of putting something akin to a terminal dues system in place (REIMS) between 15 national administrations would be amplified in national markets with (as in Germany already) over 100 licensees.

The types of service to be included in the contribution base are those defined by the USO in the Directive, namely standard letters and small standard (not express) parcels up to 10 kg. There may be a case for excluding smaller operators from the charge. This could be put into practice by defining a threshold level of revenues which would be exempted from contributions.

6.5.3. Disadvantages of a Universal Service Fund

As a result of our review of adoption of a USF solution to the financing of USOs, we identify the following problems:

1. There will be costs in identifying the costs of the extra USO burdens that need to be funded. These values will be continually disputed by those expected to contribute to the fund, who will argue that they have been inappropriately calculated and that they are too high. Although adoption of a reserved area also involves estimation of the USO burden that needs to be funded through an appropriate definition of the reserved area, we would expect that reserved area definitions would be changed relatively infrequently (though potential competitors will still argue that they are defined too widely), while the contributions that needed to be made to the USF would need to be changed on a more-or-less annual basis.
2. Estimates of USO burdens would need to be based on the costs of an efficient operator, otherwise there would be reduced incentives to efficiency, and contributors (and potential contributors) to the USF could claim that they were being required to subsidise excessive employment and/or wage levels, and inefficient working practices, of the USO provider. Calculation of the costs of an efficient operator would also present measurement difficulties; and
3. USF contributions can form an entry barrier, and reduce the impact of competition, unless a threshold level is adopted. The Finnish experience with entry may be an illustration of this. In the British telecoms market, access was encouraged by the Regulator by deliberately setting interconnection charges at a low level.

6.6. Conclusions on Financing USO Burdens

From this review of the options for financing the extra burdens imposed by USOs in postal markets we conclude that:

- imposing USOs on all postal operators is unlikely to be feasible, and reducing the scope of universal service obligations is unlikely to be acceptable to national governments;
- direct funding through taxation is administratively simple and relatively non-distortionary, though this is a matter for national governments to decide. There could also be serious incentive problems;
- franchising is attractive in efficiency terms. However, the usefulness of this approach depends on extent to which components of the business that impose extra USO burdens can be separated out and "packaged" for franchise bids;

- funding through cross subsidies within a reserved area has some economic efficiency problems. The feasibility of this approach will be informed by the results of the other postal liberalisation studies being conducted for DGXIII;
- funding through contributions from all operators to a universal service fund is likely to incur high administrative costs and to lack transparency as a result, although it allows the efficiency benefits of competition to be realised. However it does not appear sensible to set up a USF until it is clear how far liberalisation **will** impact on the scope for continued cross-subsidisation from a reserved area.

NERA concludes as follows:

1. There is no clear economic case why incumbents should suffer a burden for carrying specific types of traffic such as newspapers or printed matter. If the democratic process requires uneconomic tariffs for such traffic, the financial assistance should be made good from public funds.
2. If Saturday delivery is imposed by a USO in countries where the private parcel and express carrier service does not provide it, the regulator should allow the incumbents' tariffs to be set at a level that covers this burden. Saturday delivery should not be considered a burden in countries where the private sector offers it because of market demand.
3. The size of the counters network is often determined less by the needs of postal operations than by the obligation to provide governmental and financial transactions. Governments should fully compensate postal administrations for any extra burden imposed by the obligation to provide governmental services. Any requirement to provide a larger network than otherwise needed should be taken into account. No compensation should be paid to postal administrations for financial transactions that are also performed by the private banking sector.
4. Given the sizes of the burdens of universal service provision that we have estimated in this study, we believe that the costs of these extra burdens should continue to be met by incumbents out of profits from the reserved area, unless liberalisation in practice significantly reduces the ability of postal administrations to fund these burdens.

APPENDIX A. LESSONS FROM PREVIOUS STUDIES OF USO BURDENS IN POSTS AND TELECOMS

A.1. Introduction: the Relevance of Previous Studies

In this Appendix we review evidence from previous studies of USO costs and burdens in posts and in telecoms. There are two main reasons for reviewing this evidence. First, the evidence on posts may provide some relevant estimates of the costs of postal USO burdens in Europe. On this score, the evidence turns out to be rather limited. Secondly, the evidence may provide useful guidance on methodology, and on methodological problems. With regard to issues of methodology, the evidence is more useful. We first consider posts, and then telecoms.

A.2. Postal Services

A.2.1 An early study of the cost of the USO in the British Post Office

Tabor (1987, p.44) gave an estimate of £90 million as the extra revenue which would have to be raised to cover the losses on rural deliveries (which accounted for about 14 per cent of total deliveries at the time) in Britain. This estimate was based on fully-allocated costs, and presumed that the Post Office would continue to operate its existing mix of services.

A.2.2 Australian studies

The costs of postal USOs burdens have been estimated in Australia. The first study was that carried out by the federal government Bureau of Transport and Communications Economics (1989). In 1992 the Australian Industry Commission (AIC) recommended that the costs incurred by Australia Post in meeting its community service obligations (CSOs)⁵⁸ be funded by direct payments from the Australian Commonwealth Government. This would involve the Government paying for part of the cost of providing higher cost services so that no member of the community would have to pay more than the designated maximum charge (to be based on the existing uniform charge). The AIC stress that these cost estimates should be based on least-cost methods of providing postal services.

Australia Post is required to estimate the costs of its community service obligations. The approach takes the existing network, service standards and volume of traffic as given, and identifies the facilities and traffic which AP would not provide if it acted purely on commercial grounds. The cost of the CSO is published each year in Australia Post's Annual report.

⁵⁸ In Australia the cost of the CSO is defined as the loss of those traffics which form part of the USO, but are unprofitable. Note that this is a different interpretation of the term CSO to that referred to in Chapter 1.

The estimates of CSOs are based on long-run avoidable costs (rather than fully-distributed costs or stand-alone costs). Revenue contributions over long-run avoidable costs are also estimated. On this basis, AP estimated the losses on those traffics whose revenue contributions fell short of their long-run avoidable cost to be AUS\$60 million in 1990-91. This total could be split into two ways, first, by type of service and, second, by type of traffic flow. On the first basis, the deficit on international letters was AUS\$15 million (because of inadequate compensation under the existing terminal dues system), the deficit on domestic large letters was AUS\$12 million, and that on domestic small letters was AUS\$33 million. If the losses on unprofitable domestic traffic are split between flows, the deficit on city/city traffic was AUS\$26 million, on city/country traffic AUS\$14 million, and on country/country traffic AUS\$6 million. This indicates that the universal postal service obligation benefited urban recipients of mail as well as rural ones. This was partly because of high costs of handling mail at smaller urban post offices, and partly because of the high opportunity costs of land at city centre offices.

The approach was endorsed in a 1998 study on the competitive environment in postal services in Australia by the National Competition Council (1998). The Council accepted the NAC methodology as being preferable to alternatives such as FDC or stand-alone costs, though they believed that Australia Post's estimates of CSO costs overstated the true value of these costs.⁵⁹ This was because they believed that AP used too high a required rate of return on capital, and were too optimistic about how much overhead costs would be saved if some traffics were withdrawn. In addition, AP did not measure any benefits of universal service to offset some of the costs.

A.2.3 Swedish studies

Estimates of the costs of social policy commitments of postal administrations have also been made in Sweden. The McKinsey Report on the Swedish Post Office concluded that no compensation would be needed for rural distribution (despite the remote nature of many parts of the country). It was believed that Sweden Post could maintain its basic service without protective legislation, though this might imply a new price structure with lower charges to meet competition in the profitable market for pre-sorted mail.

In the event, Sweden Post was converted from a public enterprise into a limited company with a parent company (Sweden Post) and a number of subsidiaries in March 1994. A new regulator, the National Postal and Telecom Agency, was established to ensure that Sweden Post meets the requirements of the 1993 Postal Services Act and the terms of the agreement between Sweden Post and the Government. Sweden Post's exclusive right to mail conveyance was removed by this 1993 Act.

⁵⁹ In 1996/97 the CSO cost of rural and remote areas in Australia was AUS\$25 million, the CSO cost in metropolitan areas was AUS\$20 million, and the CSO cost of inward international mail was AUS\$22 million, giving a total cost of AUS\$67 million.

Sweden Post currently has obligations to provide a nation-wide postal service, a network of postal counters for cash transactions and bill payments and special services for the blind and the elderly and disabled in rural areas. Of these obligations, the requirement to provide a counters business is thought to be the most onerous, with cost estimates ranging from 400m SKr to 1bn SKr. The Swedish Government currently makes an annual payment to Sweden Post of 200m SKr for these services. The financial position of the counters operation is expected to continue to deteriorate as the volume of transactions has been falling rapidly, and so there is an investigation underway to look at options for dealing with this problem. The Swedish Government pays Sweden Post 44m SKr for provision of free postage services for material sent to the blind. There are no publicly available estimates of the costs of provision of universal postal services, however, this issue is currently being investigated by the Government's consultants, Coopers and Lybrand.

A.2.4 German studies by WIK

WIK (Wissenschaftliches Institut für Kommunikationsdienste) have developed a framework for estimating the burdens of USOs in postal services (Elsenbast, Pieper, and Stumpf, 1995; Elsenbast, and Stumpf, 1996). Kowalewski and Muller (1996) showed how this framework might be used to estimate Deutsche Post's USO burdens, but they used "dummy" data rather than real-world numbers.

Elsenbast, Pieper and Stumpf (1995) defined the universal service burden as:

the sum of cross-subsidies that, in the long-run, could be avoided if the universal service obligation were hypothetically abandoned. If, despite the elimination of all cross-subsidised mail flows, the universal service provider would not be able to break even on the remaining bundle of flows, the final loss would have to be attributed to the universal service burden as well.

Further, the WIK team believe the net avoided cost approach to be a useful starting point for estimating the cost of the USO. They define NAC as:

the (hypothetical) increase in profits that could be realised if all cross-subsidised mail flows (or cross-subsidised combinations of mail flows) were eliminated from the network.

This is the same broad approach as recommended in our present study.

The unit of analysis in the WIK approach is the mail flow. Mail users do not pay for mail collection, or for mail delivery, but for the combination; ie they pay to have a letter sent from A to B. Even where there is a discount for bulk delivery (with or without pre-sorting), mail users pay to have each item sent from one particular location to another.

In order to estimate USO costs, the WIK approach considers incremental costs at a number of levels, where these levels are associated with the extent to which different aggregations

share joint costs (WIK use the term common costs, to describe those costs which cannot be allocated to individual mail flows). In their description of the approach three consecutive levels are distinguished:

- **individual mail flows:** the revenue from each individual mail flow is to be compared with its incremental cost. If this revenue does not cover this incremental cost, then the loss is added to the USO cost, and the mail flow is eliminated from the flows to be evaluated in the rest of the exercise;
- **type of distribution system** (eg, foot/bike, car delivery, post office box delivery). Total revenues are next compared with incremental costs, where these incremental costs now include costs which are specific to a particular type of delivery but joint to flows within that delivery type. Losses on this basis are added to the USO cost estimate, and the associated mail flows are eliminated from the flows to be evaluated in the rest of the exercise; and
- **type of collection system** (eg public collection in low-density areas, or in high density areas, direct collection at large companies' premises). Total revenues are now compared with incremental costs, where these incremental costs now include costs which are specific to a particular type of collection but joint to flows within that collection type. Losses on this basis are added to the USO cost estimate, and the associated mail flows are eliminated from the flows to be evaluated in the rest of the exercise.

The resulting estimate of USO costs is not path-independent, so iteration is needed to see if the remaining delivery types are still profitable given that some of the mail collected for delivery has been eliminated from the network.

A final stage involves considering whether the remaining system would cover its costs. If not, the remaining losses are added to the USO cost. (If all traffics are unprofitable, then the resulting USO cost estimate ought to equal the postal organisation's actual loss, otherwise there would be something illogical about the method.)

While the approach proposed by WIK may be valid, it would need to be drastically simplified so that the data which are available from postal administrations could be used to develop credible estimates of USO burdens that are measurable in practice. The descriptions of the WIK postal method which we have seen so far have not given us a clear enough understanding as to how calculations would be carried out with real-world postal data.

A.3. Telecommunications Services

A.3.1 The relevance of telecoms experience

In this section we consider some studies of USO costs and burdens in telecoms. This experience is important because similar issues of USO burden estimation arise in telecoms as

in posts. Moreover, a number of empirical studies of USO cost estimation have been conducted in the telecoms sector.

A.3.2 Cave, Milne and Scanlan for DG-IV

In their report to DG-IV of the European Commission on universal service obligations in the telecoms sector, Cave, Milne and Scanlan (1994, p.27) describe universal service obligations as follows: “Universal service costs arise when an efficient operator is obliged to supply customers or services in circumstances where the revenues generated are less than the cost of supply. Such services would not be supplied at current prices if there were no obligation to supply”.

Cave et al. (1994) provide a useful discussion of costing universal service obligations in telecommunications. The first part of their discussion concentrates on the appropriate definition of costs. The main choices are some form of fully distributed costs (FDC) and avoidable costs. Cave et al. draw on an Australian telecommunications study to argue that both concepts have their place: the FDC approach was seen as the appropriate one if the problem was how to incorporate the universal service obligations in a financial target for the telephone company, whereas the avoidable cost one was better for determining what national resources were being devoted to meeting the obligations.

Although FDC pricing generally fits better with companies’ accounting procedures, it has drawbacks from an economic point of view: the basis of the allocation of costs is essentially arbitrary, and it does not encourage economically efficient pricing. Moreover it does not provide useful information on the existence of cross-subsidies: the normal economic definition of a subsidy-free price for a good or service is one that falls between the incremental or avoidable costs of providing it (in addition to others) and the stand-alone cost of providing it separately. Thus Cave et al. conclude that avoidable cost (of an efficient operator) is the appropriate measure. They further argue that “stand alone costs are assigned to implicitly profitable customers while remaining customers are assigned the incremental or avoidable costs of service provision” (Cave et al., 1994, p.32).

This enables them to go on and define net universal service obligation costs as “avoided revenue minus [the] avoidable costs” (Cave et al., 1994, p.38) that would follow if the service were withdrawn. In the case of telecommunications the avoided revenue is based on an allocation of subscriber revenue (with some further complications), but there are no “subscribers” in the postal case. However, it should be possible, if cumbersome, to estimate the number of items that would not be posted if particular collection or delivery points were discontinued.

A.3.3 WIK

The WIK (1997) report to DG-XIII advises on methodology for estimating USO costs/burdens in a competitive telecoms industry within Europe. The study indicates that the overall net costs (ie the burdens) of USOs will consist of direct net costs (which

themselves consist of the difference between revenues and avoidable costs on unprofitable services), less the value of indirect benefits that flow from being a universal service provider (USP). These indirect benefits include life cycle effects, enhancement of corporate reputation, ubiquity, access to a full range of telephone usage data, and advertising effects through public pay phones.

The WIK study argues that avoidable costs should be based on a long-run incremental cost (LRIC) basis. This they regard as equivalent to long-run avoidable costs.⁶⁰ They note that fully-distributed costs are not the appropriate basis on which to estimate avoidable costs, and they distinguish two approaches that are appropriate.

The first, and ideal approach, is to use data from **activity-based costing (ABC)**, since such cost models identify the costs that are incurred in providing particular activities. By using data from such an approach, it would be possible to identify the costs of particular activities and relate these costs to the revenues earned from these activities.

However, WIK note that most telecoms operators will not have cost systems of this type, and that even those which are developing such systems are unlikely to have sufficiently rigorous systems. Therefore the alternative is to use **analytical cost models** developed by the regulatory authority. This approach involves modelling of cost structures in the industry, with a view to estimating the costs of particular activities.

On analytical cost models, WIK note that such models can be constructed using generally available information about telecoms network structures and the productive processes used to provide services. WIK argue that such models can be made available to national regulatory authorities “with very little expense of time and money” (WIK, 1997, p.29). While we believe that this is, to say the least, a somewhat optimistic statement, this is the approach which is adopted in the present study. This is primarily because postal administrations have not generally adopted activity-based costing.

A.3.4 OFTEL, UK

The UK telecoms regulator OFTEL has defined USO burdens as follows:

The net cost of universal service is the difference in the universal service provider’s financial performance with and without the universal service obligation. The evaluation of the net cost is divided into two stages. The first ... is the evaluation of which customers (and exchange areas and public call

⁶⁰ “The cost standard that we propose to use in the determination of USO costs is the Long Run Incremental Cost (LRIC) caused by the USOs. The incremental cost is the cost that is caused by the activity in question, here the provision of the USOs, when it is carried out with a long-run perspective. Equivalently, looking at the question from the perspective of a T(elecommunications) O rganisation currently providing USOs, the incremental cost caused by them is equal to the costs that could be avoided in the long run if USOs were removed from the incumbent TO and it would discontinue to provide the service. As a corollary, we could therefore also say that the price should be set at the Long Run Avoidable Cost (LRAC) if USO provision is discontinued” (WIK, 1997, p.25).

boxes) are 'uneconomic' for the universal service provider to serve using an analysis of the relevant costs and revenues associated with that customer. This yields a measure of the universal service costs. But this analysis does not take into account a variety of factors that might enhance the financial performance of the universal service provider. Such factors (eg effects of universal service provision on brand image and corporate reputation, implications of ubiquity) are grouped under the label 'benefits'. To derive the net cost of universal service such benefits should be subtracted from the universal service costs....

Furthermore:

To evaluate whether or not a customer is uneconomic a comparison should be made between the costs that the universal service provider would avoid if it were to discontinue service to that customer (the long run avoidable costs) and the revenues that it would lose (the revenues foregone). Long run avoidable costs include operating costs, depreciation and a reasonable return on capital employed....

(OFTEL,1997)

OFTEL's estimates of the direct financial burdens of BT's USOs are split into three main categories:

- cost of serving uneconomic areas: £10-15 million. These areas account for less than 0.5 per cent of UK telephone lines;
- cost of serving uneconomic customers in areas of the country which are profitable: £45-55 million. These customers account for 6-7 per cent of total UK telephone lines; and
- cost of uneconomic public telephone boxes⁶¹: £10-15 million.

These estimates were based on differences between revenues foregone and long-run avoidable costs: the long-run avoidable costs include operating costs and depreciation, and also a "reasonable" return on capital employed.

These estimates were based on BT's actual costs levels, and a lower set of estimates were calculated on the basis of OFTEL's view of BT's scope for improving its efficiency.

⁶¹ Including call boxes installed since the USO obligation was imposed. OFTEL argues that BT did not have to install additional boxes, so that any that are uneconomic should not be included in the USO cost, but information to identify them is not available.

To set against these direct financial burdens of USOs, OFTEL also considered the financial benefits of providing what at first sight appears to be uneconomic service. These benefits were considered under three headings:

- life cycle effects: some customers who make uneconomic use of their phone lines might increase use to an economic level in the future, and serving them now will increase the probability that they will be “captured” in the future. It was estimated that BT might serve up to 0.8 million of the lines that are currently unprofitable for such reasons, and that the future profit prospects from this might reduce the universal service cost by between £1-10 million per annum.
- ubiquity: if BT serves all areas, potential customers will know that they can get service from BT, but may not be aware of competing suppliers. The impact of this was estimated on the basis of assumptions from a small-scale consumer survey that 66 per cent of the households who move every year and who could take telephone supply from a direct access provider are unaware that they could do so. It is further assumed that 40 per cent of these people *would* take the alternative if they were aware that it was available. With further assumptions about the rate at which potential customers then do learn about alternative suppliers and switch from BT, and about BT’s net profit per line, OFTEL estimated these ubiquity benefits to BT at £40-80 million per year; and
- brand enhancement and corporate reputation: providing universal service provides a form of marketing benefit broadly equivalent to that obtained by marketing expenditures. OFTEL assessed this impact as being equivalent to 20 per cent of BT’s Retail marketing expenditure, ie to about £50 million per annum.

OFTEL argue that these three types of universal service benefits are likely to outweigh the costs of USOs that they identified, and that as a result BT should not be compensated financially for these USOs. In a statement that also has relevance for the postal sector, OFTEL point out that “many commercial organisations choose voluntarily to retain a proportion of customers that are unprofitable at any point in time for a variety of reasons, including lack of perfect information about the identity of the unprofitable customers and imperfect targeting (ie actions to remove service from unprofitable customers may inadvertently lead to a loss of profitable customers.)” (OFTEL, 1997).

A.4. Differences between Posts and Telecoms

While we have argued that broadly similar definitional approaches to USO cost/burden definitions and cost allocation methods should be used in posts and telecoms, there will be differences in the way that the burdens are actually measured in the two sectors. In both sectors USOs impose obligations to provide universality of service across a national

territory, and usually at charges which do not discriminate by the geographical location of the customer. In addition certain specialist services must be provided at low or zero prices.⁶²

However, cost structures and technology differ between the two sectors.

- telecoms services are much more capital intensive than are postal services. This means that once a telecoms network for “delivery” of telecoms services to individual addresses has been installed, it will not be easy to adjust this network over the short run. Moreover, these capital costs must be allocated over calls made on this network over a period of time. On the other hand, postal delivery is much more labour-intensive than is telecoms, and postal delivery networks can more easily be modified if traffic levels change. In addition, total expenditures can be more easily allocated to particular geographical areas. Hence, avoided costs are larger and there are fewer problems of common costs in postal services compared to telecoms;
- technological progress is rapid in telecoms, but much less rapid in posts, especially with regard to delivery. This creates problems for measuring USO costs in telecoms, since the level of USO costs can change more rapidly over time. For example, with regard to “delivery” of telecoms service in rural areas, the substitution of fixed radio access for existing copper wires is expected to reduce the cost of supplying telecoms service to remoter areas, and thus to reduce the USO costs of supplying such areas; and
- in telecoms the same network is used for sending and receiving communications. In posts the outgoing network (collection) is largely separate from the incoming network (delivery). This means that it does not necessarily follow that if delivery in one area is uneconomic, then collection will be too, or vice versa.

These differences mean that the pattern of USO costs will be different in posts as compared to telecoms:

- the relationship between costs and revenues for different services differs considerably. For example, long distance telephone calls are generally considerably more profitable than local calls because tariffs for the former are high relative to those for the latter. By contrast, in posts city-to-city mail may be less profitable than within-city traffic because of the uniform tariff;
- the fixed costs of installing and maintaining a connection to a particular customer in telecoms are significant, and typically connection charges and line rentals do not fully recover these costs. Hence, if customers make relatively few telephone calls they may be uneconomic to serve, even if they are located in an economic area. The fixed costs of “connection and maintaining the connection” in posts are relatively

⁶² Emergency calls are a common example in telecom services.

small once a postal service is being supplied in an area.⁶³ Hence we would expect that the cost of serving uneconomic customers in economic areas would be less significant for posts than for telecoms; and

- the fact that telecoms charges are paid in arrears means that some customers do not pay their bills, and so are uneconomic to serve for this reason. This situation does not apply in posts, where postage must be pre-paid.

We should note that we cannot conclude anything general about the relative sizes of USO burdens in relation to, say, turnover in posts versus in telecoms. The fact that posts generally require a uniform tariff, whereas telecoms does not, need not necessarily imply that one service requires more cross-subsidy than the other.

A.5. Conclusions: the Lessons from Previous Studies of USOs

We draw the following main lessons from the evidence:

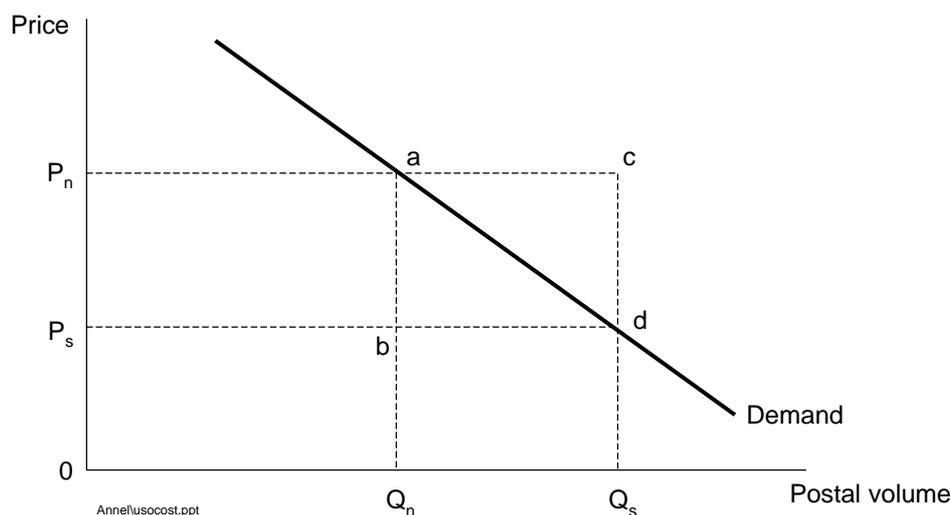
- actual evidence of USO burdens in postal services in Europe is sparse. This is confirmed by the results of our survey of postal administrations and ministries;
- there is a general agreement in both posts and telecoms that the net avoided costs methodology, with avoided costs based on long-run avoidable costs, is the appropriate one;
- in postal services, both the Australian and WIK studies base analysis on the costs and revenues of individual mail flows. We have not been able to obtain data at this level of disaggregation in the present study;
- while the cost of serving uneconomic customers in otherwise economic areas may represent a significant part of USO burdens in telecoms, technological differences between posts and telecoms means that this issue is much less likely to arise in posts, because of the absence of fixed infrastructure to each address which needs to be installed and maintained irrespective of use. Also, problems of bad debts will not arise in posts; and
- overall estimation of USO burdens needs to take account of commercial benefits of universal service as well as costs, though existing methods to measure these benefits are relatively crude. Moreover, the types of benefit identified in telecoms services are broadly different from those in posts. Universal service provision may provide a benefit broadly akin to general marketing in postal services, as it does in telecoms, but the benefit of ubiquity is rather different. In posts there will be a benefit to many

⁶³ If no post is delivered then the costs are not incurred, unlike in telecoms where the final link to the customer will be supplied and maintained even if there is no traffic for long periods of time.

high volume mailers in knowing that they can serve all addresses using the postal service.

APPENDIX B. ESTIMATING THE USO BURDENS OF CONCESSIONARY OR ZERO TARIFFS

Figure B.1
Burdens of Concessionary Tariffs



If the postal administration is required to carry some traffics at a low (or zero) price, when it would not be in its commercial interest to do so, then there is an additional USO burden.

This is illustrated in Figure B.1. The normal postal rate for the type of item concerned is P_n , but the postal administration is required to carry this traffic at a lower rate of P_s per item.⁶⁴ At this price, the actual traffic of this type carried per period of time is Q_s .

If the postal administration had been able to charge P_n per item for this volume of traffic, it would have gained extra revenue equal to the area $P_s P_n cd$ on the diagram. However, such a higher price would reduce traffic to Q_n , so the extra revenue gained in practice would be area $P_s P_n ab$ (the extra revenue on the traffic retained) minus area $Q_n bd Q_s$ (the loss of revenue from the traffic not retained as a result of the higher price). In addition the postal administration would gain any savings in cost from having to carry the lower volume of traffic.

The net USO burden of the concessionary tariff P_s is therefore:

$P_s P_n ab - Q_n bd Q_s$ + any extra operating costs from the higher traffic carried as a result of the concession.

⁶⁴ P_s could be zero, as is the case for items for the blind, which are carried free under UPU rules.

This in turn is equal to:

$$(P_n - P_s)Q_n - (Q_s - Q_n)P_s + (Q_s - Q_n)C_m \quad (1)$$

where C_m is the extra cost per unit of traffic.

While Q_s is the actual, observable, traffic volume, the value of Q_n will depend on the responsiveness of traffic volume to price changes, ie on the elasticity of demand.

The arc elasticity of demand between points a and d on the demand curve is equal to:

$$e = \frac{Q_s - Q_n}{P_s - P_n} \frac{P_s + P_n}{Q_s + Q_n}$$

which can be solved to yield Q_n in terms of e , $(P_s - P_n)$ and Q_s .

Thus:

$$Q_n = \frac{Q_s (1 - e \frac{(P_s - P_n)}{(P_s + P_n)})}{(1 + e \frac{(P_s - P_n)}{(P_s + P_n)})} \quad (2)$$

This enables us to solve for the USO cost given information on:

1. P_s : the actual price charged for this type of traffic.
2. P_n : the normal postal tariff for traffic of this weight etc.
3. Q_s : the actual volume of this traffic carried in a year.
4. e : an estimate of the elasticity of demand for this type of traffic
5. C_m : the cost saving per unit of traffic if volumes were to be reduced as a result of a price increase.

APPENDIX C. COUNTRY APPENDICES

C.1. Austria

C.1.1 Introduction

Table C.1
Austria - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996
Area of territory (square kms)	83,859	83,859	83,859	83,859	83,859	83,859	83,859
Population (thousands)	7,690	7,769	7,868	7,962	8,015	8,040	8,055
Population density (people/km ²)	92	93	94	95	96	96	96
Employees				34,572 ¹	34,725	34,003	32,414
Average number of deliveries per week in all areas	5	5	5	5	5	5	5
Average number of deliveries per week in rural areas	5	5	5	5	5	5	5
Number of households without postal delivery	0	0	0	0	0	0	0
Number of delivery points (million)							3.7
Letter mail service (millions of items delivered)	3,219	3,211	3,077	3,266	3,484	3,404	3,442*
Number of post offices	2,317	2,322	2,327	2,320	2,325	2,328	2,331
Revenue (AS million)							
Operating costs (AS million)							
Operating profit/(loss) (AS million)							

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996, Annual Reports, Questionnaires

* total number of items delivered 1996

¹ Figures from 1993 onwards are for postal employees only

C.1.2 Background

An important new postal Act (Postgesetz 1997) came into force on 1st January, 1998, setting out the framework within which postal operators including Post und Telekom Austria (PTA) are to operate. The Federal Ministry for Science and Traffic (Wissenschaft und Verkehr) is responsible for the regulation of posts. The Act draws on the EC's postal directive which was at a late draft stage when the Act was passed.

C.1.3 Universal service obligations (USOs)

Under the Act, universal service is defined as follows:

"The operator shall ensure that customers enjoy the right to a universal service consisting of the permanent provision of postal services at all points in their territory at affordable prices and of a quality that meets the needs of the customers by providing an appropriate density of the points of contact and the points of access and by an appropriate frequency of clearance and delivery. Technical developments and overall economic, regional and social

aspects as well as customer demand must be taken into account in the provision of universal service."⁶⁵

The Act states that "The charges for reserved postal service and for postal newspaper delivery must be identical for all customers. The application of a uniform price for universal postal service does not exclude the right of the universal service provider to enter into special price agreements with customers individually".⁶⁶ While these two sentences appear contradictory, that latter appears to give the universal service provider the freedom to provide large customers with discounts. In other countries this is normal for bulk and presorted mail, since the service provider shares with customers the economies of bulk handling and presorting. However, the reference to *customers individually* may be seen as enabling special prices for special customers.

The Act is intentionally flexible on what constitutes "appropriate density" and leaves this to be determined by an ordinance from the Ministry, which NERA was told is at draft stage but not yet available as such. A further element of flexibility is contained in the Act's requirement that "Identical service must be offered to customers, *provided conditions are comparable*" (emphasis added). This clearly permits different levels of service where there are significant differences — for example, in density of delivery points and the nature of the terrain.

Under the Act "In principle, the PTA must provide universal service throughout the Federal Territory..." However, "If the proper provision of universal service throughout the Federal Territory by the PTA is no longer ensured, the highest ranking postal authority must transfer by administrative decision (license) the reserved postal service in its entirety to an operator.⁶⁷ The Act also enables competitors to enter the market. "Upon application, operators can be authorised by administrative decision to provide universal service in specified geographic areas or with regard to specified matters."⁶⁸ Thus, competitors may be required to provide a more limited "universal service".

The USO includes:

- the service of various forms of official documents⁶⁹.

⁶⁵ Postgesetz 1997, §4(1)

⁶⁶ Postgesetz §10(2)

⁶⁷ Postgesetz §5.

⁶⁸ Postgesetz §5(3).

⁶⁹ Postgesetz §7.

The Act also states that the PTA is "entitled to provide its facilities, also free of charge, to operate a military postal service"⁷⁰; a service for tracing missing persons and mail for the blind.⁷¹

PTA is permitted to assert a claim through the Federal government for remuneration of services for the public benefit. These are clearly obligations that fall within the concept of USO, but if they are correctly remunerated by the government, they do not constitute a burden.

Part 3 of the Act relates to newspaper delivery as being "...among the services for which the Federal Government (Bund) grants the operator remuneration for performing services of overall socioeconomic benefit on behalf of the Federal Government". The type of printed items that qualify as postal newspapers appears to be drawn widely in the Act, and includes associations for the public benefit, legal interest groups, domestically recognised churches or religious communities.

Although the Act does not state explicitly that the PTA's tariffs for newspapers shall be below cost, the implication is clear because:

- "A Price Commission must be set up at the Federal Ministry of Science and Transport to Advise the Federal Minister...with regard to the approval of terms and conditions of business and charges for the reserved postal service and for postal newspaper delivery";⁷² and
- "Postal newspaper delivery is among the services for which the Federal Government (Bund) grants the operator remuneration for performing services of overall socioeconomic benefit on behalf of the Federal Government."⁷³

The Act states that "the government shall remunerate the operator at most the difference between the established charges for the transport of newspapers versus those for transport of comparable postal items. If there are no comparable postal items, the compensation must be set in any case at an amount equal to the difference between the required, demonstrable costs and the charges established for newspaper transport."⁷⁴ The clear intention is that newspapers shall be carried at concessionary rates and that the government shall pay the difference without, apparently, an element for profit by PTA.

⁷⁰ Postgesetz §22.

⁷¹ Postgesetz §23.

⁷² Postgesetz §11.

⁷³ Postgesetz §15.

⁷⁴ Postgesetz §15(1).

C.1.4 Reserved services

The Act defines these as "The provision of postal services for personally addressed items of correspondence containing written messages up to a weight of 350 grams". The main exceptions are:

- printed matter with no personal message;
- express delivery services with a fee at least five times what the PTA charges for the delivery of a domestic letter;
- documents accompanying a consignment of goods;
- document exchanges; and
- postal items with written messages conveyed by the sender him/herself or by an agent.

The PTA also has the reserved right to produce and issue postage stamps, and may issue one stamp with a surcharge annually. The surcharge may not exceed 50 per cent of the nominal value of the stamp and the proceeds have to be used 80 per cent to advertise Austrian postage stamps and 20 per cent to support PTA employees in need.⁷⁵

C.1.5 Actual service provision

As noted, the Act does not specify the minimum standards of service provision, though these are expected to be included in the ordinance when this is published. The current principal standards for mail services provided by PTA are:

- one delivery of mail (items up to 2KG) per day, five days a week. Delivery may be to the door, grouped boxes in blocks of flats; roadside boxes in rural areas; and in some outlying areas a small number of addressees have to pick up their mail at the post office;
- Saturday delivery, but only of newspapers;
- one collection per day in rural areas, 2-3 in towns and 4-5 in urban agglomerations and cities; and
- 89 per cent of letters are delivered on D+1.

For parcels, only 88.4 per cent of addresses are served to the door and currently 96.4 per cent are delivered by D+2.

⁷⁵ Postgesetz §19.

There are about 6,000 wholly owned post office counters and 265 agency counters. NERA was not provided with standards concerning maximal distances between counters or what proportion of the existing network may be considered unprofitable.

C.1.6 Regulatory responsibilities

As noted, the Ministry is also the regulator and has the final say on PTA's prices. However, under the Act the Ministry must set up a price commission to advise the Minister concerning approval of conditions of business and charges for the *reserved* postal service and for newspaper delivery.⁷⁶ The Ministry also has final regulatory responsibility for standards of service and for determining the amount that PTA should be reimbursed for losses made on services provided free or at subsidised rates. These losses are based on a contract that is negotiated every two years between the ministry and the PTA.

C.1.7 Costs and USO burdens

APT provided NERA with a breakdown of operational costs for postal traffic. These data are shown in Table C.2.

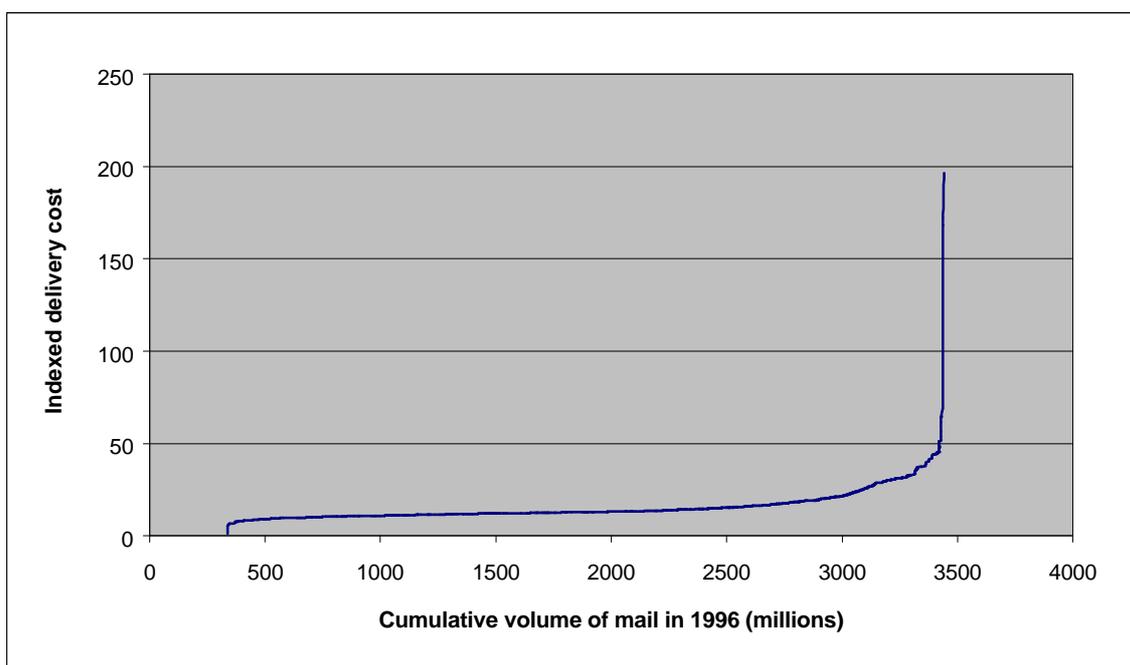
Table C.2
Cost Proportions for APT

	Letters to 2kg	Parcels 2-10kg or above
Collection	22%	18%
Outward/Inward sorting	22%	11%
Trunking/Transport	2%	26%
Delivery	54%	45%
Overhead costs (not included in the above)	0%	
Total	100%	100%

Further data on costs per item were supplied. These included the delivery volumes for 2017 delivery centres. Of these 2017, 2004 centres had figures for the cost per item delivered (the 13 other centres dealt with such things as deliveries of internal Parliamentary mail, and had no cost figures. These other centres accounted for 780,000 items, less than 0.0023% of the total traffic). We were thus able to calculate a delivery cost index for Austria. This delivery index covers all mail. The resulting index is shown in Figure C.1.

⁷⁶ Postgesetz §11.

Figure C.1
Delivery Cost Index for Austria



In order to calculate USO burdens, we assessed avoidability of costs other than delivery using cost elasticities for different functions. Since we did not have direct evidence from Austria⁷⁷, we based these on econometric estimates from other countries, and used values of 0.05 for collection, 0.8 for both inward and outward sorting, and 0.3 for transport.⁷⁸ These values imply that if traffic is withdrawn from the network, a ten per cent fall in traffic would in the long run lead to a one half per cent fall in collection costs, an eight per cent fall in sorting costs and a three per cent fall in transport costs.

Under these assumptions, our model estimated the burden of the USO for letter mail in Austria, on a fully distributed cost basis, as 2,115 million schillings in 1996, and, on an avoidable cost basis, of 1,177 million. The latter figure represents the amount over the price of the services that would be saved if the "unprofitable" part of the service were withdrawn. Our estimate of 2,115 million for the USO burden on a fully-allocated basis represents 14.3

⁷⁷ APT informed NERA that reductions in traffic volumes or in the delivery network would produce cost savings only over a five year period because of the difficulty of reducing the number of postal staff, given their status as civil servants.

⁷⁸ We assume no changes in unallocated costs when traffics change.

per cent of PTA's turnover in 1996, while the figure of 1,177 million represents 8.0 per cent of turnover in that year.

The above figures **include** newspapers.

C.2. Belgium

C.2.1 Introduction

Table C.3
Belgium - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996
Area of territory (square kms)	30518	30518	30518	30518	30518	30518	30518
Population (thousands)	9947.8	9987	10022	10068.3	10100.6	10130.6	10143
Population density (people/km ²)	326.0	327.2	328.4	329.9	331.0	332.0	332.4
Employees	45954	46133	46046	46127	44914	44462	
Average number of deliveries per day in urban areas	2	2	1	1	2	2	2
Average number of deliveries per week in rural areas (6 = Saturday delivery of newspapers only)	5(6)	5(6)	5(6)	5(6)	5(6)	5(6)	5(6)
Number of households without postal delivery	0	0	0	0	0	0	0
Number of delivery points (million)							4.5
Letter mail service (millions of items delivered)	3141	3224	3237	3256	3316	3276	
Number of post offices	1821	1822	1816	1756	1639	1635	
Revenue (BF million)						66893	66248
Operating costs (BFmillion)						65109	66331
Operating profit/(loss) (BF million)						342	-747

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996

C.2.2 Definition of universal service obligation

Before the law of 21 March 1991, La Poste was a department of state (La Régie des Postes). It then became La Poste and in 1992 it became a public autonomous enterprise (entreprise publique autonome) under the responsibility of the minister of the economy and telecommunications under the law of 21 March 1991. It currently operates under a management contract (Le deuxième contrat de gestion, 10 January 1997) which runs for five years until 1 January 2002.

Despite its increased commercial freedom, La Poste still carries the legacy of having been a department of state. It is the largest employer in Belgium and its staff has largely retained the employment conditions they had as civil servants: they have employment for life and cannot be made redundant. Before 1991 La Poste was sometimes required by ministers to recruit unemployed people who were not needed operationally, many with few educational qualifications. We were informed that, as a result, La Poste is significantly overstaffed and that efforts to upgrade the skills of such employees have proved disappointing.

Except for franking machines and its power to trade and determine infringements of the postal law⁷⁹ La Poste has no regulatory authority as such. By contrast, the Institut belge des services postaux et des télécommunications (IBPT), though not a regulator, has a significant role in advising the ministry on important matters concerning La Poste's postal and financial services. Effectively the ministry is also the regulator, but relying extensively on IBPT's detailed knowledge of La Poste's operations. In particular the IBPT assists the minister in negotiating the contract between the ministry and La Poste under which La Poste operates. IBPT carries out studies of La Poste's operations and drafts laws and regulations. IBPT also plays a role in the determination of La Poste's costs based upon the criteria of efficient management and quality of performance.

A further regulatory influence is that of the government's commissioner (commissaire du gouvernement). Under the law of 1991⁸⁰ the commissioner monitors that the law is kept concerning the statutory organisation of the public enterprise and its management contract.

There is also a consultative committee (Comité consultatif pour les service postaux) comprising an independent chairman, a secretariat provided by IBPT, and representatives from a very wide range of bodies including La Poste itself, various ministries, trade unions, small and medium enterprises, the self-employed, consumer organisations, families, the press, philatelists, the regions and postal experts. This body acts as a sounding board for postal matters but has no regulatory power.

In 1996 La Poste published a consumers' charter (*La Poste à votre service*) which sets out the services and the quality of service that its customers can expect.

C.2.3 Universal service obligations

Under article 141 of the law of 1991 La Poste is obliged to collect, transport and deliver throughout the kingdom:

- letters both open and sealed;
- post cards; and
- publicity material, circulars, prospectuses, price lists and any form of communication provided that the item bears the address of the addressee.⁸¹

Under article 142, La Poste must

- provide at least one collection box for each "commune" or section of a commune;

⁷⁹ Articles 134 and 136 of the law of 1991.

⁸⁰ Article 23 §2.

⁸¹ Questionnaire response from La Poste, p4.

- make at least one collection, transmission and delivery of mail per day except on Saturdays, Sundays and public holidays;
- provide delivery to every address in the kingdom providing that there is a letter box placed adjacent to the public highway, within range of a hand and conforming to regulations of the ministry and the IBPT.⁸²

The second management contract (the Contract) stipulates further tasks as part of La Poste's universal service obligation. These include⁸³:

- a postal order service (le Postchèque);
- an international parcels service in accordance with UPU conditions;
- deposits and payments for other financial institutions;
- distribution of daily papers and periodicals, including those published on a not-for-profit basis, throughout the Kingdom at prices that may be lower than costs. Saturday delivery is obligatory for daily papers;
- a postal banking service to be made available to every citizen of 12 years and over; and
- various forms of official communication for organisations such as the supervising service of the police, ombudsmen, the social security system CPAS, and election material.

In the domestic parcels sector, La Poste's service runs in parallel with the domestic parcels service provided by ABX, a subsidiary of SNCB (the Belgian railway). In the international parcels sector, La Poste, as provider of the public service, can outsource the international parcels service to a transport company.⁸⁴

The postal banking service has recently been spun off into a 50/50 owned venture with Générale de Banque.

La Poste's counter USOs include:

- issue and payment of postal orders;
- payment of pensions;
- payment of staff used to run elections;

⁸² Questionnaire response from IBPT, pp5-6.

⁸³ Contrat de gestion, p5.

⁸⁴ This is permitted under Article 2 of the Arrangement on parcels of the UPU Convention.

- printing and sale of stamps for licences on behalf of the Belgian-Luxembourg administrative commission;
- accounting for road fines, fishing licences and entitlements issued by the national office of annual holidays.

Other general services that may be undertaken by La Poste under the contract include:

- printing and delivery of electronic mail, though this service has not yet been offered;
- a service of certifying messages;
- social service functions provided by postmen in rural and deprived areas; and
- providing facilities for the printing and distribution of official forms, offers of employment and entrance exams for the civil service.

Article 3 of the Contract lays down that the prices of letters and printed material should be affordable and accessible to all citizens. Prices must be based on costs. Separate accounts must be kept for the reserved and non-reserved areas, using commercial principles that ensure their transparency. For the public services undertaken exclusively by La Poste, separate accounts must be kept for each service. Domestic letter tariffs must be uniform and variations relating to distance of collection and delivery are expressly prohibited. However, La Poste may give discounts to customers on the basis of the services such as pre-sorting that they carry out.

The state has specific power to set tariffs below costs in the case of :

- election material whether or not addressed;
- public material described above ("franchise de port"); and
- newspapers and periodicals.

La Poste is required to invoice the state periodically on the basis of actual costs for the services provided below cost.

C.2.4 Reserved services

The main reserved services consist of:

- the receipt, transportation and delivery of letters;
- printed election material; and
- various forms of public communication such as those of the police.

Many of the services undertaken by the banking and counter side of La Poste, such as postal orders and the payment of pensions are also reserved to La Poste, but these lie outside the scope of NERA's study.

The letter monopoly used to be widely interpreted until the landmark ruling in the ECJ's *Corbeau* judgement.⁸⁵ This was as follows:

"It is contrary to Article 90 of the EEC Treaty for legislation of a Member State which confers on a body such as the Régie des Postes the exclusive right to collect, carry and distribute mail, to prohibit...an economic operator...from offering certain specific services, dissociable from the service of general interest, which meet the special needs of economic operators and call for certain additional services not offered by the traditional postal service, in so far as those services do not compromise the economic equilibrium of the service of general economic interest performed by the holder of the exclusive right".

A regulation (arrêté) of 9 December 1997 laid down the following exceptions to La Poste's monopoly for services that cumulatively provide, subject to the terms and conditions specified in the regulation:

- express delivery
- tracking of postal items through the system; and
- recorded acceptance and delivery of each item.

The regulation also excludes from the monopoly any express mail weighting 350 grams or over or with a tariff higher than five times the price of a standard letter.

The present legislation is in line with the requirements of the Directive and may bring new entrants to the express delivery market.

C.2.5 Actual service provision

In addition to stipulating the collection and delivery obligations noted earlier, La Poste's Contract lays down standards of quality. These include:

- precise and up-to-date information to customers about its services including an annual edition of its consumers' charter;
- a current structure of five principal sorting centres ("centres de tri industriels"), 66 principal post offices and 507 delivery offices. La Poste is allowed to adapt this structure but any significant changes, particularly those that would reduce its density, has to be agreed with the ministry. La Poste must keep a maximum distance

⁸⁵ Case c-320/91, issued on 19 May 1993.

between post office counters of five kilometres with at least one post office per commune;

- The waiting time on average at counters should be no more than four minutes;
- 90 per cent of "priority"⁸⁶ letters should be delivered by D+1 and 97 per cent by D+2 measured by the end-to-end method;
- 85 per cent of cross-border EU mail should be delivered by D+3 and 97 per cent by D+5 measured by the end-to-end method;
- Latest collection times are:
 - 17.00 hrs normally;
 - 19.00 hrs from a main post office; and
 - 20.00 hrs from the five main sorting centres.

The quality of service for priority letter delivery cited by La Poste for 1997 was 95.3 per cent at D+1, and 99.6 per cent by D+2.⁸⁷ This represents a significant improvement compared with 85.1 per cent at D+1 in 1992.

C.2.6 Regulatory responsibilities

Final regulatory responsibility lies with the Ministry of Telecommunications though, as noted earlier, the influence of IBPT is considerable on how the ministry exercises this responsibility. On all significant issues, in particular in the drafting of the Contract, the IBPT "gives advice...proposes...carries out research" etc. In essence, IBPT proposes, the ministry disposes. The ministry has the final say on prices, standards of service and numbers and location of post office counters. On 1 April 1998 La Poste had 1,679 counters, all of which are its own. On 1 May 1998 200 of these were closed because they were insufficiently profitable.⁸⁸ La Poste considers that there may be further unprofitable counters, but the reduction in May has taken it to the limits of what is permitted under the Contract.

La Poste has the final say on investment and return on capital. It makes no profit and so to date there has been no question of paying a "dividend" to the exchequer. Losses on the postal business appear to have been met from profits on telecommunications.

⁸⁶ In this context "priority" means standard letters as opposed to printed material.

⁸⁷ Questionnaire response, Q6.6, p18.

⁸⁸ La Poste questionnaire, Q8, p24.

C.2.7 Costs and USOs

Until the publication of the EC's postal directive, La Poste had used an accounting system that, NERA was informed, produced unreliable management accounting data. To remedy this, a firm of accountants has been given the task of completely revising La Poste's system. This task will not be complete until the end of the year. Until then no reliable data can be provided.

As an example of the broad estimates that have been used in the past in place of accurate accounts, the state made payments to La Poste in respect of losses made on

- postal services such as the delivery of newspapers and public service traffic carried free or at rates below costs; and
- financial services as described earlier.

The payments for 1994, 1995 and 1996 for postal services were BeF 5.45 billion in each year. The payments for financial services in 1993, 1994 and 1995 were BeF 10.00 billion in each year. However, in 1997 the postal payment was BeF 6,431,343,254 and the financial services payment was BeF 2,160,792,637.

C.3. Denmark

C.3.1 Introduction

Table C.4
Denmark - Basic Statistics

	1992	1993	1994	1995	1996
Area of territory (square kms)	43080	43080	43080	43080	43080
Population (thousands)	5162	5181	5197	5216	5251
Population density (people/km ²)	119.8	120.3	120.6	121.1	121.9
Employees (full-time equivalent)	25636	25221	25108	25030	25478
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	6	6	6	6	6
Number of households without postal delivery	0	0	0	0	0
Letter mail service (millions of items delivered)	1831.0	1733.5	1720.1	1698.1	n.a.
Number of post offices	1321	1293	1291	1273	1247
Revenue (krone million)				8938	9364
Operating costs (krone million)				7702	8100
Operating profit/(loss) (krone million)				364	347

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996, Post Denmark Annual Report and Accounts 1996. Notes: Employee numbers include radio telecommunications; operating profit is after depreciation costs are subtracted and after tax.

Post Denmark is an independent public company. The legal basis of the company is the Act on Post Denmark, and the Act on Postal Service, both of which were adopted by the Danish Parliament on January 31st 1998. The Act on Post Denmark allows the company to operate as a normal business enterprise in competition with an increasing number of postal service providers. At an annual or extraordinary meeting of the Board, the Minister responsible for Post Denmark exercises, as a state representative, the powers of ownership normally vested in the general meeting of a public company.

C.3.2 Definition of universal service obligation

The USO is defined in Section 2 of the Bill on Postal Business (Bill No. L89 of 8 February 1995), in Sections 7-24 of the Executive Order on the Concession Granted to Post Denmark (Executive Order No. 126 of 23 February 1995) and in Sections 1-5 of the Executive Order on the Use of Post Denmark (Executive Order No. 119 of 22 February 1995).

The main obligation as set out by the Bill is to ensure nation-wide postal conveyance (that is, collection, transport and distribution) of addressed letters and other addressed consignments (including catalogues and brochures), daily, weekly and monthly

publications and magazines, addressed parcels and consignments for the blind (Section 2(1) of the Bill). There is a requirement of uniform tariffs.

The Executive Order on the Concession Granted to Post Denmark specifies the USO to comprise the following:

- Domestic letters and other addressed items weighing up to 1,000 gr;
- International letters weighing up to 2,000 gr;
- Newspapers and magazines weighing up to 500 gr;
- Domestic parcels weighing up to 20 kg;
- International parcels up to 31.5 kg depending on bilateral agreements; and
- Literature for the blind weighing up to 7 kg.

This covers collection from letter boxes, post offices, post shops and other collection points, transportation and delivery of mail.

C.3.3 Reserved business

The USO is defined in Sections 3-7 of the Bill on Postal Business (Bill No. L89 of 8 February 1995) and in Sections 6-7 of the Executive Order on the Use of Post Denmark (Executive Order No. 119 of 22 February 1995).

The Executive Order on the Use of Post Denmark specified the reserved area as:

- The sole right includes domestic addressed letters and addressed letters from abroad to Denmark weighing maximum 250 gr (Part 2).

C.3.4 Actual service provision

The USO specifies that for letters there must be one delivery each working day (including Saturdays), and no delivery on Sundays. For letters and newspapers, delivery to businesses takes place by 10:00 am at the latest, and delivery to private addresses by 13:00 pm at the latest.

For parcels, the USO specifies similar delivery conditions, except that on Saturdays no delivery is required. Delivery of business-to-business parcels is completed by 10:00 at the latest, delivery of business-to-private parcels by 19:30 pm at the latest, and private-to-private parcels also by 19:30 pm at the latest.

Post Denmark has an obligation to deliver to the addressee's door (in 1997 1.744 million addresses), to roadside boxes (0.550 million addresses), to groups of boxes (0.156 million

addresses), to grouped Post Office boxes (0.055 million addresses) and to boxes intended for holiday cottages (0.200 million). Post Denmark serves all these 2.705 million addresses. There are no addresses without delivery.

The USO also specifies speed of delivery targets. The service standard for parcels (up to 20 kg) is next-day delivery between all towns, with the exception of towns on the island of Bornholm where an extra day is permitted. The service target of this service is 99 per cent. Regarding letters and newspapers, speed of delivery targets are as follows: 97 per cent of priority letters have to be delivered the next day, 97 per cent of non-priority letters have to be delivered 3 to 4 days after collection and 100 per cent of newspapers have to be delivered to next day.

Table C.5 shows the actual performance in 1997:

Table C.5
Post Denmark's Speed of Delivery Performance, 1997

Postal item	Actual performance (%)
Parcels	
Business-to-business and business-to-private addressees	95.3
Private-to-private addressees	94.2
Letters	
Priority letters	94.2
Non-priority letters	95.8
Newspapers	98.7

As far as frequency of collection is concerned, a minimum of once per day on working days is specified in the USO. The actual collection can take place up to four times a day in towns on working days.

C.3.5 Regulatory responsibility

In Denmark, the Ministry of Transport is responsible for drafting new laws relating to the postal sector. There is a Postal Supervisory Board, which is part of the Ministry of Transport, which executes postal laws. Finally, the Danish Competition Authority oversees the postal sector (and other sectors) for issues related to competition law (there are separate *Competition law guidelines for Post Denmark* dealing with amongst other permissible cross-subsidies).

Responsibility for prices lies with the Ministry and with Post Denmark. For the reserved area (domestic letters up to 250 gr), a price cap holds that is developed by the Ministry of Transport and applied by the Postal Supervisory Board. The price cap model is based upon the development of the consumer price index with a deduction of 1 per cent for efficiency improvements. Several weight categories of priority and non-priority letters are inputs in the price cap calculation. The price cap is applied on an annual basis. For postal services

with USO, tariffs are determined by Post Denmark, taking into account market conditions and the obligation to provide nationwide services at uniform tariffs. For products and services outside the reserved area without USO restrictions, Post Denmark sets tariffs as a function of market conditions.

Post Denmark is solely responsible for investments.

Regarding return of capital, the Ministry and Post Denmark share responsibility. The Danish government is the sole shareholder of Post Denmark. Post Denmark is required to pay one-third of its profit as dividend to the Government or a 6 per cent of rate of return, whichever amount is highest.

Post Denmark is responsible for standards of service but has to take into account the legal standards. The Postal Supervisory Board controls the actual performance.

The number of counters is a joint responsibility of the Ministry and Post Denmark. It is up to ministerial discretion whether or not counters can be closed. There is an obligation for Post Denmark to maintain a dense network of counters. In 1997 Post Denmark had 601 own counters and 626 agency counters. Agency counters include post shops in supermarkets and petrol stations. Post Denmark has indicated that overall its network of counters is (slightly) profitable but that some parts of the network are less profitable or even unprofitable. A closing down of counters has taken place in the last years, but has generally been compensated by new agency counters.

C.3.6 Costs and USO burdens

The following data were supplied by Post Denmark:

Table C.6
Cost Proportions for Post Denmark

	Letters (mail up to 2 kg)	Parcels	Letters and parcels combined
Collection/Clearance	5	7	5
Outward/Inward Sorting	9	9	9
Trunking/Transport	5	18	8
Delivery	43	30	40
Overhead costs (not included in the above)	38	37	38
Total	100	100	100

The following ways of collection are used for mail up to 2 kg:

- Letter boxes, which are cleared at least once a working day. Clearance is either done by a postal sorting centre or the local post office. A number of letter boxes in rural areas are cleared by mailmen during delivery or by local bus companies.
- Post offices: all types of mail can be delivered by customers at all post offices. Most post offices pass on the mail to the nearest sorting centre. Some larger post offices carry out limited sorting (small/C4, C5 and flats) before transportation to the sorting centre.
- Directly from customers: Post Denmark collects mail directly from a number of big customers. Collection is done either by the local post offices or by sorting centres. As above, some larger post offices carry out limited sorting (small/C4, C5 and flats) before transportation to the sorting centre.
- Self delivery at sorting centres: big customers may deliver the mail directly to the sorting centre. Usually, this happens according to a special agreement specifying mail volume and time of delivery.
- Mailmen in rural areas: during delivery in rural areas, mailmen may also collect mail.

In the short run, collection costs would not be reduced when volumes were lower. In the longer run, there would possibly be fewer letter boxes, and costs of direct collection and self delivery would be moderately reduced.

With respect to the collection of parcels, again various ways of collection are employed. 43 per cent of all parcels are collected through Post Offices, 50 per cent are collected by Post Denmark directly from big customers and 7 per cent are self delivered by customers to sorting centres. If parcel volume decreased, in the short and long run, some variable costs would possibly be reduced. Long term reduction in fixed costs would depend on the extent of changing volume and its geographical and timewise distribution. It would also depend on changes in the volume and composition of the drop in mail volume.

The proportion of postal items up to 2 kg delivered in urban areas (including postboxes) is 87 per cent, while the remaining 13 per cent is delivered to rural areas. Post Denmark does not have estimates of delivery costs by item (up to 2 kg) by type of area.

Neither Post Denmark nor the Ministry have estimates of the burden of the Danish postal USO. Post Denmark indicated that, with a small number of exceptions, costs are more or less the same for different routes. The practice for remote areas is that mailmen combine the delivery and collection activities, thus reducing costs.

However, we have made a broad estimate of the USO burdens of universal delivery in Denmark based on the split of traffic between urban and rural areas noted above. On the

basis of experience from other countries, and in the absence of detailed data from Denmark, we have used a ratio of 1.5 between unit delivery costs in rural areas and unit delivery costs in urban areas. We also used cost elasticity estimates from other countries, of 0.05 for collection costs, 0.80 for sorting costs, and 0.30 for transport costs.

NERA's estimate of the USO burden of letter mail in Denmark based on fully-allocated costs is 136 million Danish krone. Our estimate based on net avoided costs is zero, given in particular that we cannot identify any areas of Denmark that have particularly high unit delivery costs. The estimate of USO burdens on a FDC basis represents 2.3 per cent of Denmark Post's revenue from the 1,462 million items of letter mail delivered in 1996.

Regarding parcels up to 20 kg, all delivery is done by motor transport. By type of area, 27 ml parcels are delivered to urban areas and 6 ml to rural areas. Costs vary by a factor 2 for urban compared to rural areas. By type of address, 32 per cent is delivered to private households and 68 per cent to other addressees. Costs vary by a factor 2 for private households compared to other addressees.

In the annual report by Post Denmark a cross-subsidy from the monopoly area to the competition area with universal service obligations is being made explicit. The cross-subsidy is for one of the elements of the USO, the distribution of newspapers, magazines and periodicals. The accounting practice to make this subsidy explicit reflects a political decision to subsidise these media and to have no more hidden cross-subsidies. The method used is fully-allocated cost method. In 1996 the cross-subsidy amounted to Dkr 203 million. In addition to this a state subsidy for the distribution of newspapers, magazines and periodicals was added, equal to Dkr 503 million (in 1997: Dkr 495.6 ml). The total of cross-subsidy and the state subsidy can be regarded as the costs of this particular element of the USO.

Post Denmark gave as a rough estimate that the burden of providing free post services to the blind were around Dkr 35 ml in 1997.

C.4. Finland

C.4.1 Introduction

Finland Post Ltd is a limited liability company wholly owned by the state.⁸⁹ It operates under a licence granted by the Minister of Transport and Communications in 1994 to provide unrestricted postal services for an indefinite period.

Finland Post is organised into the following businesses:

- Messaging services (40 per cent turnover) which collect, convey, sort and deliver letters;
- Logistics services (18 per cent turnover) which provide a competitive logistics and delivery service for parcels;
- Media services (26 per cent turnover) which deliver newspapers, magazines, and addressed and unaddressed direct mail;
- Counter services (12 per cent turnover) provide postal and banking services and insurance policies to households and cash-on delivery services to businesses. Postipankki, the postal bank, is responsible for providing these services and it does so using post office counter facilities, for which it makes a payment to Finland Post;
- Other services (4 per cent turnover) include philately, security transport services and bus services.

Regulation of postal services is governed by the Act on Postal Services 1993, the Decree on Postal Services 1993 (which provides details of the general regulations set out in the Act) and Finland Post's operating licence 1994.

The Ministry of Transport and Communications (the Ministry) has overall responsibility for the regulation and development of postal services, and must ensure the general availability of basic postal services. The Ministry has powers to impose universal service conditions on postal operators, lay down criteria for the terms of delivery and issue rules for their publication.

The Telecommunications Administration Centre (TAC) is responsible for ensuring compliance with the Postal Services Act through day to day regulation of the sector. It also deals with consumer complaints and other consumer related issues (eg service standards), UPU matters and provides advice on postal matters to the Ministry.

⁸⁹ Finland Post has been a subsidiary of the PT Finland Group together with Telecom Finland and other associated services. Telecom Finland is to be privatised this year leaving Finland Post and related activities (e.g. automotive services) as a state owned limited company.

Postal services have been liberalised. Finland Post's monopoly formally ended in 1991. Provision of postal services for unaddressed mail, newspapers, magazines and parcels is unregulated i.e. service providers are not required to be licensed under Postal Services Act (see Section 1 of the Decree on Postal Services). To provide other postal services, in particular collection and delivery of mail under 2 kg whose dimensions are no more than 25cm x 40cm x 3cm, operators must be licensed. To date there have not been any licensed operators other than Finland Post. The reasons for this are discussed in Section C.4.3 below.

Table C.7 provides summary statistics for Finland Post's operations.

Table C.7
Finland - Basic Statistics

	1993	1994	1995	1996	1997
Area of territory (km ²)	338,127	338,127	338,127	338,127	338,127
Population (thousands)	5,040	5,070	5,090	5,110	5,120
Population density (people/km ²)	14.9	15	15.1	15.1	15.1
Turnover (FIMm)	4,526	4,851	4,948	5,213	5,507
Operating profit (FIMm)	205	356	420	491	439
Total number of staff	25,358	24,481	26,537	24,574	25,696
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	5	5	5	5	5
Percentage of the population without postal delivery	0	0	0	0	0
Postal items (millions)	1,925	1,924	2,386	2,374	2,553
Number of post offices	2,135	1,879	1,791	1,709	1,700*
Primary of post offices	952	946	927	737	700*
Sub post offices	1,183	933	864	972	1000*

na: No data available

* = Approximate numbers

Source: Eurostats Demographic Statistics 1997; Finland Post Annual Reports

C.4.2 Universal Service Obligations

A major purpose of the Postal Services Act (the Act) is to ensure that post can be sent and received under equal conditions throughout Finland. In particular, the availability of postal services and the fairness of costs must be ensured for sparsely populated regions. These

universal service obligations apply to items up to 2 kilograms in weight which can be delivered to a standard-sized letter box.⁹⁰

Finland Post is required to meet a universal service obligation as defined in Sections 7 and 8 of the Postal Services Act. Section 7 provides for a standard delivery which refers to the regular mail delivery carried out every working day i.e. delivery to all addresses five days a week. Section 7 allows the operator to take local conditions into account when fulfilling their delivery obligation. Section 8 refers to a nation-wide delivery and discusses the placement of devices and minor constructions needed for the receipt and delivery of postal services. The universal delivery obligation applies to delivery to a box at the end of the drive or a group of boxes (say in blocks of flats).

Packages above 2 kg in weight are only delivered to the nearest post office, unless a surcharge for home delivery is paid. Addresses which are located more than 5 km from a post office receive free home delivery of parcels.

There is no formal obligation on Finland Post to set uniform tariffs. Rather it is required that "post can be sent and received on equal conditions" (Section 1 of the Act) and that payments collected shall be fair and in reasonable proportion to the average costs incurred" (Section 4 of the Act). "Fair" is not defined in the Act. In practice uniform tariffs are charged. Finland Post has no formal obligations to offer discounts for particular types of mail.

There is no formal obligation on Finland Post concerning the number of post offices it operates.

C.4.3 Reserved Service and Competition

There is no reserved service in Finland, however, operators wishing to collect and deliver mail of less than 2 Kg in weight must be licensed. In principle, operator licences are granted subject to the applicant being well established and capable of providing regular postal services. Licences may contain restrictions on the scope of services to be provided.

Finland Post has the only licence to provide nation-wide postal services. The main reason why competing operators have not entered the market is that they are required to pay a fee or tax to the Government as a condition of their licence, the intention being to create a level playing field for competition with Finland Post. The terms and conditions for payment of such a fee are set down in the Act on the Fee Collected for Securing the Provision of Postal Services in Sparsely Populated Areas, August 1997. Article 4 of this Act states that:

⁹⁰ Finland Post does not have an obligation to deliver post in the Province of Aland Islands.

“The amount of the fee is the percentage, mentioned in paragraph 2, of the sales price which the fee is based upon.

The percentage is calculated by dividing the population density (number of inhabitants per square kilometre of the land area) in the concession area at the end of the previous calendar year by the figure of 50 and rounding off the resulting amount to the nearest whole number. The percentage may not be greater than 20. The fee is not collected in a concession area where population density is less than 250 inhabitants per square kilometre of the land area.”

Thus, if an operator applied for licence to serve only Helsinki it would have to pay 20 per cent of its revenues as a tax to the Government.

Initially there were two applicants for licences. One of applicants - Suomen Suoramainota Ltd - was given a licence for delivery in Helsinki but withdrew because of the 20 per cent revenue tax. This applicant has since re-applied for a licence covering an area much wider than Helsinki for which the population density is sufficiently low to mean that no tax would be paid. The Government has refused to issue the licence and this decision is now being appealed in the courts.

C.4.4 Actual Service Provision

In practice mail is delivered once a day five days a week to all addresses. The distribution of mail by type of address is as follows:

- 43 per cent to the door;
- 52 per cent to a roadside box; and
- 5 per cent to groups of boxes and poste restante.

Finland Post sets its own internal service quality targets of 95 per cent of first class letters delivered the day after posting (and 100 per cent by D+2) and 95 per cent of second class letters within three working days of posting (and 100 per cent by D+4). In 1997, its actual performance was 92 per cent for first class letters and 94 per cent for second class mail. Finland post delivers 83 per cent of parcels two days after posting. These levels of service are considered acceptable by Government.

Discounted delivery of newspapers was traditionally funded by government. However, subsidies for newspaper deliveries ended in 1995 because of pressures on the state budget.⁹¹ Finland Post has since increased prices.

⁹¹ 49m FIM subsidy was given to Finland Post in 1995.

Finland Post gives discounts to delivery of braille items. There is no formal obligation for it to do so.

C.4.5 Regulatory Responsibility

Finland Post has control over most aspects of its operations. It determines prices, investment, service quality, and the number of post offices. Finland Post reports twice a year to the Ministry on its performance and on compliance with the terms of its operating licence.

The Ministry sets the level of returns required by the state, determines the overall legal structure within which Finland Post operates and deals with EU matters. The Ministry is not involved in regulation of tariffs. If prices were raised "too high", then Finland Post could be subject to an investigation by the competition authorities.

The Telecommunications Administration Centre (TAC) is responsible for ensuring compliance with the Postal Services Act through day to day regulation of the sector. It also deals with consumer complaints and other consumer related issues, UPU matters and provides advice on postal matters to the Ministry.

C.4.6 Costs and USO burdens

Detailed data on the structure and level of Finland Post's costs exists. Table C.8 shows the broad breakdown of mail service costs by function. Finland Post has also supplied us with detailed delivery cost data for 270 areas. Each of these areas is served by one or several delivery offices. These delivery offices are managed as a unit with management functions located at only one of the several offices in the group.

Table C.9 shows the breakdown of addressed mail and its relative costs by each of the broad eight delivery regions in Finland. As would be expected delivery costs are higher in rural, less densely populated regions (eg Northern Eastern Finland).

Table C.8
Cost Proportions for Finland Post

	Letters (mail up to 2kg)	Parcels (packages 2-10kg, or above 10kg)
Collection/clearance	13	9
Trunking/transport ¹	10	33
Sorting (inward and outward)	20	18
Delivery	50	34
Overhead costs which are not included in the above (incl. Headquarters)	7	6
TOTAL	100	100

¹ *Transport costs include collection and delivery transport i.e. transport to the inward sorting centre and from the outward sorting centre to the delivery office. About a third of the transport costs are due to trunk transport.*

Table C.9
Finland - Delivery Costs and Volumes for Different Areas, Addressed Mail, 1997

Area	Delivery Costs		Proportion of Addressed Mail	
	Urban (Capital area = 100)	Rural	Delivery	Collection
Capital area (Helsinki and surroundings)	100		19.4%	60.9%*
Etela-Suomi (South Finland)	123	263	14.0%	*
Lounais-Suomi (South-Western Finland)	116	246	13.5%	8.3%
Sisa-Suomi (Central Finland)	128	266	13.3%	10.5%
Kaakkois-Suomi (South-Eastern Finland)	124	290	9.2%	4.1%
Pohjanmaa (Ostrobothnia)	117	158	9.1%	3.9%
Ita-Suomi (Eastern Finland)	119	296	9.1%	6.8%
Pohjois-Suomi (Northern Finland)	116	283	12.5%	5.5%
TOTAL	116	253	100%	100%

Notes

The delivery cost data reported in this table refers only to the costs of outside work (on the route).

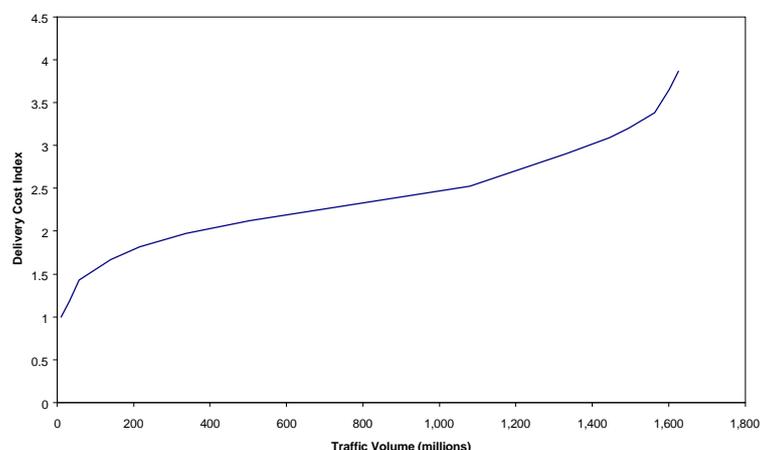
* *Most of the mail collected in South Finland is outward sorted in Helsinki sorting centre (Pasila).*

We have estimated USO burdens using the methodology described in the main report and the detailed cost data supplied to us by Finland Post. Figure C.2 shows the shape of the delivery cost curve.

We estimate USO burdens on a fully-allocated cost basis as 29 million FIM.

Finland Post was only able to give us short run avoided costs, rather than long-run avoided costs. On this basis we estimated the USO burden as zero. The long run avoided cost estimate of USO burdens will be less than that based on fully distributed costs i.e. less than FIM 29 million. The figure of FIM 29 million represents 0.7 per cent of turnover in 1996.

Figure C.2
Delivery Cost Index in Finland



C.5. France

C.5.1 Introduction

Table C.10
France - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996
Area of territory (square kms)	543964.6	543964.6	543964.6	543964.6	543964.6	543964.6	543964.6
Population (thousands)	56577	56893.2	57217.6	57529.7	57779.1	58020.1	58255.9
Population density (people/km ²)	104.0	104.6	105.2	105.8	106.2	106.7	107.1
La Poste employees	299785	297428	296660	292784	289156	289250	
Average number of deliveries per week in urban areas	6	6	6	6	6	6	6
Average number of deliveries per week in rural areas	6	6	6	6	6	6	6
Number of households without postal delivery	0	0	0	0	0	0	0
Number of delivery points (million)							28.1
Letter mail service (millions of items delivered)	20265	21394	22038	23238	24288	24306	
Number of post offices	16967	16945	16855	16877	16919		17012 ⁹²
Revenue (FF million)							
Operating profit / (loss) (FF million)			711	1357	3310	(375)	776
Net profit/ (loss) (FF million)		301	60	(1235)	195	(1151)	(648)

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996

La Poste operates under the law No 90-568 of 2 July 1990. This gave as its mission as a public operator (exploitant public): to provide both domestic and international postal services as well as the transport and delivery of the press under the latter's special regime.⁹³ Secondary legislation is Decret No 90-1214 of 30 December 1990, which sets out La Poste's duties in more detail (cahier des charges de la Poste). A third element of La Poste's regime is a planning contract (contrat de plan entre l'Etat et La Poste, 1995-1997). In general, this contains broad aims rather than detailed targets.

The contract requires La Poste to prepare for a gradual and managed opening up of competition in the postal sector. The above texts require La Poste to achieve a financial balance (équilibre) in its activities. The cahier des charges requires it to make a suitable profit to enable the self-financing of its investments.⁹⁴ The Contract requires La Poste to balance each of its services and to avoid any form of cross-subsidy which would distort competition.

⁹² Figure for 1998, from NERA's questionnaire to La Poste. Includes agency post offices

⁹³ Article 2.

⁹⁴ Article 26.

C.5.2 Definition of universal service obligation

In France the definition of universal service obligations are based on the law of 2 July 1990 and its "cahier des charges".⁹⁵ These require:

- service throughout the territory;
- equal treatment of users;
- quality and availability of La Poste's services; and
- the neutrality and confidentiality of its services.

La Poste's accounting system as regards its postal services was examined by the European Commission in the context of whether its express service SFMI-Chronopost had received subsidies, and the Commission stated that it was satisfied that the system can be used to ensure the absence of cross-subsidies between La Poste's diverse activities.⁹⁶

The system has been used to estimate the cost of the special tariff at which newspapers are carried, but other services have not been similarly costed. For example, the counters' network is seen as part of the "management of the territory" and even if parts of the network are underused, the profitability of individual post offices within it is not calculated.⁹⁷

La Poste considers that, in addition to the losses it makes on its newspaper delivery obligation, it bears significant additional OSU costs in addition. For example, on the cost of Saturday delivery, La Poste informed NERA that this was part of the USO but the cost had not been estimated.⁹⁸

In November, 1997 proposals were invited by the Ministry for the Economy, Finance and Industry for a study concerning the economic and social impact of changes in the legal framework of postal services. It is intended that this study will produce an appropriate definition of postal USOs and their cost in France. At the time of NERA's interview with the Ministry in May, 1998, the selection of consultants was still taking place.

The underlying concept of postal services in France is that they form part of a wide strategy covered by Law No 95-115 for the management and development of the territory.⁹⁹ This law's purpose is to promote national unity and solidarity. Thus, La Poste's services are seen as a single network rather than a group of cost or profit centres. Under the law, any decision by a public body to reorganise or stop a service to users must be preceded by an impact

⁹⁵ Loi No 90-568, 2 juillet 1990, article 8, and cahier des charges, articles 2,3 and 4 in particular.

⁹⁶ Commission decision, 1 October 1997, Official Journal L 164, 9 June 1998, p 37.

⁹⁷ La Poste's response to NERA's questionnaire, question 8.2.2.

⁹⁸ Communication dated 9 July 1998.

⁹⁹ Loi No 95-115 du 4 février d'orientation pou l'aménagement et le développement du territoire.

study which must consult the municipal councils and other bodies.¹⁰⁰ La Poste is not mentioned specifically in this law, but NERA was told that the three most important symbols of civic consciousness are: the office of mayor, a police station and a post office.

La Poste operates under Law No 90-568. Article 8 stipulates the following:

- service must cover the entire national territory;
- there must be equality of treatment for users;
- La Poste must ensure the quality and availability of the services offered;
- it must participate in the development and management of the territory; and
- it must contribute to defence and public security.

More detailed specification of La Poste's responsibilities are given in Decree No 90-1214 of 29 December 1990 and in the planning contract (le Contrat de Plan entre l'Etat et la Poste) for 1995-1997.

Under Articles 2 and 3 of the decree, La Poste must:

- deliver mail once each work day, which includes Saturday;
- collect from letter boxes at least once a work day
- charge uniform tariffs; and
- take account of the needs of the handicapped.

Articles 8 to 13 sets out an extremely wide range of financial services that La Poste must offer covering postal orders, national savings and insurance.

Article 6 of the Decree gives the carriage and distribution of newspapers as a service *obligation*, possibly the only time that this term is found in a lengthy act of 49 articles. Article 6 states that this obligation is intended to encourage pluralism, notably that of political and general information. The tariffs for carriage and distribution of newspapers are fixed by decree.

Under the Contrat de Plan, 1995-1997, La Poste's targets for letters is to deliver 80 per cent on D+1 and 96 per cent by D+2 in metropolitan France. The target for business mail is 83 per cent on D+1 and 90 per cent for intracity mail.¹⁰¹

¹⁰⁰ Article 29.

¹⁰¹ Contrat de Plan entre l'Etat et La Poste, Annexe 2.

The density of providing counters, either in terms of numbers or maximum distances between them, does not appear to be stipulated in the Law of 1990¹⁰² or the Contrat de Plan. La Poste states that there has been no reduction in the number of post offices since 1993 because of a moratorium on all public sector institutions preventing the closure or reduction of rural offices generally or reducing their levels of service. However, La Poste does not consider individual offices as profit centres and considers the counter network to be one financial entity.¹⁰³

C.5.3 Reserved services

La Poste has exclusive rights to the carriage of letters. In addition, legally it also has the exclusive right to carry "packets and papers" up to 1 kg, but this right has fallen into disuse and the market for parcels is totally liberalised.

Exclusions to the reserved service are:

- bags containing legal papers;
- papers that relate uniquely to the staff of transport undertakings; and
- newspapers, periodicals and printed items of whatever weight, provided that they are in a wrapper, an unsealed envelope or packet in which they can be verified easily.¹⁰⁴

C.5.4 Actual service provision

La Poste delivers once a day, Monday to Saturday except in Paris where there are 2-3 deliveries a day from Monday to Friday and two deliveries on Saturday. Collections are carried out six days a week on a regular basis. The times of latest collections or the completion of deliveries are not specified in the material received by NERA.

As noted earlier, La Poste's targets for letters under the Contrat de Plan is to deliver 80 per cent on D+1 and 96 per cent by D+2 in metropolitan France. The target for business mail is 83 per cent on D+1 and 90 per cent for intracity mail. The measurement of actual performance is to be carried out by an independent organisation.¹⁰⁵ There are no delivery targets for non-priority mail or for parcels.

¹⁰² Loi No 90-568, 2 juillet 1990

¹⁰³ La Poste's questionnaire, Q8.3, p23

¹⁰⁴ La Poste, questionnaire, p10.

¹⁰⁵ Contrat de Plan entre l'Etat et La Poste, 1995-97, 101.

Actual performance in 1997 for letter delivery within metropolitan France was 77.2 per cent on D+1 of and 93.6 per cent by D+2.¹⁰⁶

C.5.5 Regulatory responsibility

The sponsoring ministry is the Ministry of the Economy, Finance and Industry and the regulator is the Secretary of State for Industry. The Ministry's responsibilities are:

- cosignature for the Contrat de Plan;
- examination of La Poste's receipts and expenditure as well as completed accounts;
- approval of tariffs for the reserved services, and being informed in advance about other tariffs;
- authorisation of the establishment of subsidiaries and joint ventures above a certain level; and
- organising La Poste's economic and financial control.

The Ministry has substantial influence over

- tariffs for the press;
- any reduction in the number of post offices; and
- salaries of la Poste's staff since these are civil servants.

Tariffs for newspapers are intentionally set below costs for the reasons given in Section C.5.2 earlier. NERA was informed that the cost of the service is around FFr 7 billion with about one third borne by the press itself, one third by the state, and one third by La Poste.¹⁰⁷

Further responsibilities of the Ministry relate to ensuring that La Poste conforms to public policy concerning

- the location of all its buildings, from its headquarters to its local offices;
- its public obligations including the numbers of handicapped and blind people that it employs;
- its employment of young people; and

¹⁰⁶ La Poste questionnaire, p15.

¹⁰⁷ NERA interview with the ministry, 15 May 1998.

- developing use of the Internet by installing it in post offices.¹⁰⁸

C.5.6 Costs and USO burdens

La Poste provided NERA with a breakdown of costs for its main constituent postal activities which combine letters and parcels. Counter services are identified separately as regards their postal activities. The cost breakdown is shown in Table C.11.

Table C.11
Cost Proportions for La Poste

	Proportion
Collection ("concentration")	5.6%
Outward/inward sorting	15.7%
Trunking/transport	5.6%
Delivery	39.7%
Overhead costs (including counters) not included in the above cost categories	33.5%
Total	100%

On the delivery of letters, La Poste was able to provide data taken from a one week survey that is carried out each March¹⁰⁹ relating to the different costs of delivery by:

- density of delivery area; and
- mode of delivery (eg foot, cycle and motorised).

In the first of these, the length of a delivery round is related to the number of delivery points. Thus, the fewer the delivery points per 100m, the longer the amount of time taken per delivery point. These data reveal the relative time per item for different parts of the total traffic, even though they do not reveal the cost per item delivered. However, the data reveal that the ratio of the amount of time per delivery point between the lowest density (less than 0.5 delivery points per 100m) and the highest (over 6 delivery points per 100m) is equal to 2.4.

La Poste also provided the unit cost of delivery by the following residential¹¹⁰ modes.

- urban motorised;
- urban foot/cycle;

¹⁰⁸ La Poste questionnaire, p15.

¹⁰⁹ This statistic is known as "742"

¹¹⁰ La Poste defines "rural" as being communities with less than 10,000 inhabitants.

- rural motorised; and
- rural foot/cycle.

The ratio of the most expensive mode (rural motorised) to the least expensive (urban motorised) in 1996 was 2.9. Between rural and urban deliveries, the ratio was 1.74. The implied delivery cost indices by these two alternative measures are shown in Figure C.3 and Figure C.4 respectively.

Figure C.3
Delivery Cost Index, Based on Density of Delivery Area for France

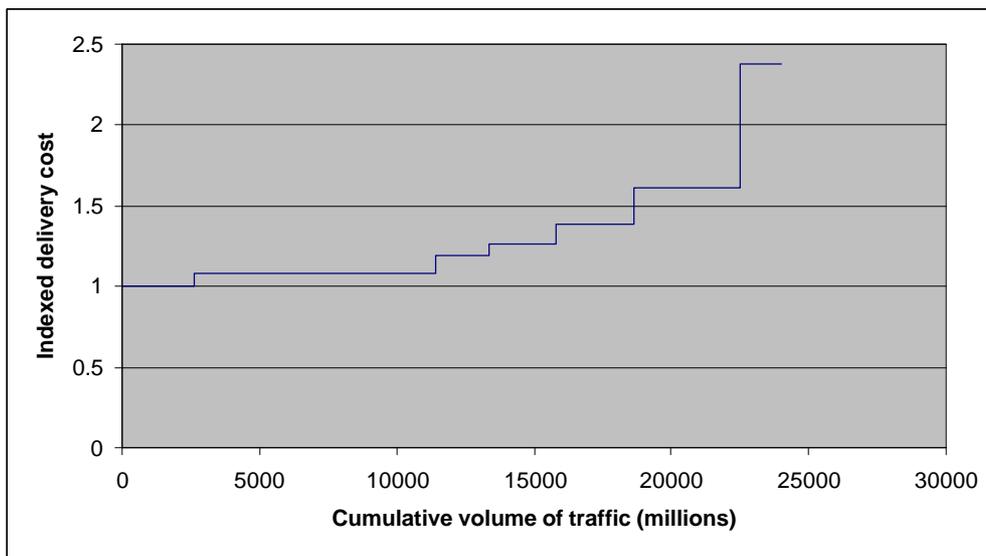
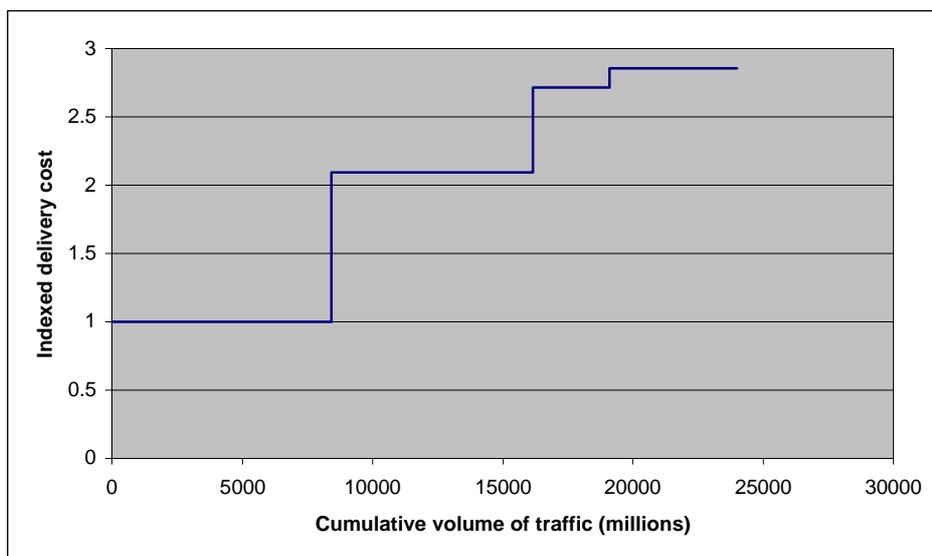


Figure C.4
Delivery Cost Index, Based on Mode of Delivery for France



We then used these delivery cost indices, together with the cost proportions in Table C.11, to make alternative calculations of USO burdens in France.

The resulting estimate of USO burdens on a fully-distributed cost basis using the time per unit variant of the delivery cost curve in Figure C.3 was FF 2,239 million, while using the delivery cost per item curve in Figure C.4 the fully distributed cost estimate was FF 3,691 million. These fully-distributed burden estimates represent, respectively, 3.8 per cent, and 6.2 per cent of NERA's estimate of La Poste's mail turnover in 1997.

In order to estimate USO burdens on a net avoided cost basis, it was necessary to make assumptions about the variability of different cost components with regard to traffic volume. Recent detailed studies of sorting costs for La Poste show elasticities below one. If a ten per cent change in total volume occurs as a result of a change in first and second class letters and the proportions of first and second class mail in the stream are equal to the national average, then the implied elasticity is 0.83, that is a ten per cent change in mail volume will lead to an 8.3 per cent change in sorting costs in France in the long run (estimated from information in Aligon et al, 1998).

Since we did not have specific elasticity estimates for other mail functions in France, we used estimates from other studies of 0.05 for collection, and 0.30 for transport.

Given the step-function shapes of the delivery cost curves available for France, the relatively high proportion of overhead costs (33.5 per cent) that we have treated as fixed, and the assumptions made about cost-avoidability at the aggregate level, our model was unable to reveal any savings in net costs from withdrawing the unprofitable traffics when using the net avoided cost method in France. This result primarily reflects the level of aggregation we have had to use given the data available.

C.6. Germany

C.6.1 Introduction

Table C.12
Germany - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996
Area of territory (square kms)	356718	356718	356718	356718	356718	356718	356718
Population (thousands)	79112.8	79753.2	80274.6	80974.6	81338.1	81538.6	81817.5
Population density (people/km ²)	221.8	223.6	225.0	227.0	228.0	228.6	229.4
DP employees	277691	279990	33407	362716	342413	307388	284889
Average number of deliveries per week in urban areas	6	6	6	6	6	6	
Average number of deliveries per week in rural areas	6	6	6	6	6	6	
Number of households without postal delivery	0	0	0	0	0	0	0
Number of delivery points (million)							
Letter mail service (millions of items delivered)	15892	16664	17929	18802	18893		
Number of post offices	29285	25895	22004		19479		
Revenue (DM million)						28567	29323
Operating costs (DM million)						28229	28952
Operating profit/(loss) (DM million)						364	576

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996

C.6.2 Background

An important new postal Act, the Postgesetz, was passed on 22 December 1997. Its intention is to increase competition by liberalising the market and so to prepare Deutsche Post AG (DP) for eventual privatisation. A new independent regulator covering telecoms and posts was created by law (das Telekommunikationsgesetz) in August 1997 and the authority began work on 1 January 1998. In the past, DP's losses were absorbed by Deutsche Telekom. However, a new law of 14 September 1994¹¹¹ Deutsche Post, Deutsche Telekom and Deutsche Postbank became companies with shares (Aktiengesellschaften) from 1 January 1995 making any further cross-subsidies impossible. Further, these are illegal under the law. The regulator is not required to estimate USO costs but Section 16 of the Act contains provisions for a compensation levy on licensees in the postal market with turnover of more than DM1m.

Since 1995 there has been competition for the conveyance of bulk-mail. In 1995 competition was permitted for items weighing more than 250g, and in 1996 the threshold was reduced to 100g. At the end of 1996 there were more than 100 competitors to DP in the bulk mail sector

¹¹¹ Post und Telekommunikationsneuordnungsgesetz (PTNeuOG).

and additional licences are still being given. We were informed that new licensees have a combined turnover of about 5 per cent of the inland market.

C.6.3 Definition of universal service obligation (USO)

The terms of universal service of the Act are broad and flexible, and more detail is contained in the regulation known as the PUDLV that is in course of preparation.¹¹² The Act states "The Federal Government shall be empowered to define, by ordinance requiring the consent of the German Bundestag and the German Bundesrat, the content and scope of universal service. The definition of universal services shall be adapted to technical and social developments in line with demand."¹¹³ However, the Act also states that "Universal services are a minimum set of postal services ... provide in specified quality throughout the Federal Republic of Germany at an affordable price".¹¹⁴ The obligation to provide postal services throughout Germany has been included in the licence awarded to DP for the period up to 31 December 2002 in return for its reserved services. The intention is that DP should be given the opportunity to develop from being a classical administration — with all its restraints — into a modern and efficient postal operator. After 2002 it is possible that DP's USO will be removed, presumably along with its reserved services. The shares in DP are owned by the government but the placing of shares on the stock market is foreseen.

The Act does not state specifically that prices shall be uniform but "Rates subject to approval may not...create any advantages for individual users in relation to other users of postal services of the same type..."¹¹⁵ NERA was informed that this would not prevent DP from charging higher rates, say, for postal services in remote areas.¹¹⁶

The Act defines letter post items "as addressed written communications...Communications not addressed to an individual by name ...shall not be deemed to be addressed...Catalogues and publications...such as newspapers and magazines shall not be deemed written communications..."

The PUDLV restricts the letter post obligation to items weighing up to 2 kilos and conforming to the UPU's size limits. The maximum weight of parcels is 20 kg, also with the UPU's restrictions as to size.

Letter mail services are defined to include

- registered and recorded deliveries;

¹¹² Post-Universaldienstleistungsverordnung (PUDLV). The version available to NERA is dated 30 January 1998.

¹¹³ §11 Abs.2.

¹¹⁴ Postal Act, section 11(1).

¹¹⁵ Postal Act, §20 Abs.2. Nr.3.

¹¹⁶ Communication from the Bundesministerium für Wirtschaft to NERA, 3 July 1998.

- cash on delivery; and
- special delivery.

Specific exceptions to the definition of letter mail include:

- items that require special handling because of their content or dimensions; and
- services that require a minimum quantity of more than 50 pieces per consignment.¹¹⁷

Since DP is now a company with shares (Aktiengesellschaft), it has no obligation to provide services at prices below costs. Newspapers and periodicals used to be carried at uneconomic tariffs, but this is no longer the case. However, we were informed that Braille items for the blind are carried free.¹¹⁸

On the density of post office counters, PUDLV requires that in cohesively built-up residential areas customers should as a rule have to go no further than two kilometres to the nearest counter. The nearest posting box must as a rule be within one kilometre and should be cleared, assuming that use justifies it, on weekdays and also Sundays and public holidays as well as work days. The "as a rule" condition evidently will permit exceptions.

In the absence of a questionnaire from DP, we do not know whether either of the requirements on provision of counters or posting boxes is considered to be uneconomic and hence part of the USO. At interview NERA was informed that DP does not have data on which post office counters are profitable or loss-making. Data are collected on the basis of the number of transactions and the supposition is that those with fewest transactions are less likely to be profitable. It is DP's policy to replace DP counters (about 10,000) when appropriate by agencies of which there are currently about 5,000. In addition, DP runs more than 17,000 mobile post offices which provide counter services along with postal deliveries.

C.6.4 Reserved services

Neither the act nor the draft PUDLV refers to reserved services as such. Instead, section 51 of the Act gives DP a statutory fixed-term exclusive licence ending on 31 December 2002. The licence provides the exclusive privilege to convey letter post items and addressed catalogues weighing not more than 200 grams each and costing not more than five times the rate applicable on 31 December 1997 for the appropriate postal items in the lowest weight category. The main exclusions from the licence are:

1. letter post items having identical contents weighing more than 50 grams and with a minimum of 50 items (ie direct mail);

¹¹⁷ PUDLV §1 Abs.3 Nr.1 and Nr.2..

¹¹⁸ NERA interview with DP, 6 May 1998

2. document exchanges
3. services distinct from universal services, having special features and higher quality (ie express services);
4. any person collecting letter post items from the sender and mailing them at the nearest DP acceptance office within the same community;
5. any person collecting letter post items from DP PO box facilities and delivering them to the addressees; and
6. and any person charged with providing a universal service by virtue of bids solicited according to Section 14 of the Act.

Collectively, these exceptions represent a significant liberalisation of the postal market.

(1) appears to open up a significant part of the direct mail market. 50 grams is the equivalent of about 10 sheets of 70 gsm paper plus an envelope. Direct mail houses will be able to put, say two or three leaflets in one envelope to bring the weight over the 50 gram mark

A document exchanges system, (2) above, is a specialist niche service that began in the UK and has been begun in a small number of other countries including Belgium and France. The German postal market is now open to document exchange systems, and other markets will become so as they implement the postal directive which specifically excludes document exchanges from the services that may be reserved.¹¹⁹

Express services are covered by (3) but these have been in place for a number of years.

(4) represents a form of downstream access. It permits private suppliers to collect from individual third parties within the community and to deliver the mail to DP for onward transmission. The definition of community will be important. If towns or cities are defined as communities the volumes of mail to be collected in this way could be significant. In practice small firms (mainly individuals) collected mail and delivered it to DP. Full tariffs had to be paid so DP suffered no loss and tolerated these services. It will be interesting to note whether in the future DP considers that such consolidation of collections by third parties produces cost savings that should be shared with the consolidators and their customers.

(5) represents a further form of downstream access which could open the way for competing local delivery services.

It is too early to evaluate the potential development of (6) because such services would be licensed only if DP defaulted on its USOs and the services concerned were put out to tender.

¹¹⁹ Directive 97/67/EC Article 7.4.

C.6.5 Actual service provision

Sections 2 and 3 of PUDLV define quality standards for counters, the mail services and parcels. Some of the main standards are as follows:

- on average, 80 per cent of inland letters must be delivered on D+1 and 95 per cent by D+2. Cross-border EU mail must achieve 85 per cent delivery by D+3 and 97 per cent by D+5;
- delivery of mail is to the address unless the addressee has informed DP that he will collect mail;
- deliveries must be at least once per work day;¹²⁰
- for parcels, customers in cohesively built-up residential areas should have to go no further than two kilometres to hand in a parcel and the facilities for doing so should be open on work days (ie six days a week);
- on average, 80 per cent of parcels should be delivered by D+3 and 97 per cent by D+5; and
- parcel delivery is to be made to the named address and deliveries are to be made at least once per work day.

In 1996 91 per cent of inland letters were delivered by D+1 and 99 per cent by D+2, so the two quality targets were comfortably exceeded.¹²¹ In 1996 91 per cent of inland letters were delivered by D+1 and 99 per cent by D+2, so the two quality targets were comfortably exceeded.¹²² In the first quarter of 1998 94.8 per cent of letters were delivered on D+1 and 99 per cent by D+2.¹²³

C.6.6 Regulatory responsibilities

The sponsoring ministry for postal services is the Federal Ministry of Economics (BMW). The regulator is the Regulatory Agency for Telecommunication and Post¹²⁴, which was established on 1 January 1998, replacing the former Federal Ministry for Post and Telecommunication. The tasks of the former Federal Ministry for Post and Telecommunication were divided into ministerial and regulatory tasks. The Ministry is working on the laws and ordinances, for example: PUDLV and the tariff regulation (Entgeltregulierungsverordnung). The regulator is the Regulatory Agency for

¹²⁰ Although Saturday is not formally defined as a workday, it is clearly such because Section 2.2 of PUDLV specifically mentions only Sundays and public holidays as being distinct from workdays.

¹²¹ Deutsche Post AG *Geschäftsbericht* p52.

¹²² Deutsche Post AG *Geschäftsbericht* p52.

¹²³ <http://www.regtp.de/postwesen/brieflauf.htm>, 22 July 1998.

¹²⁴ Regulierungsbehörde für Telekommunikation und Post

Telecommunication and Post, which was established on 1 January 1998. Among the tasks and aims of the regulator are:

- consumers' interests;
- postal secrecy;
- ensuring efficient competition in the market;
- ensuring universal service at affordable prices;
- the award of licences;
- setting compensation payments for the costs of universal service;
- regulation of prices; and
- monitoring quality.¹²⁵

C.6.7 Information available on costs

DP did not return NERA's questionnaire, but limited cost information was sent at a later date. This revealed that delivery accounts for 69.4 per cent of the costs of processing mail. A further breakdown was provided showing the average delivery cost of a letter in rural areas, intermediate areas and conurbations respectively (Landbereich, Verdichtungsraum, Ballungsraum). The ratio of the highest cost (rural) to the lowest (conurbation) in 1997 was 1.16. In addition the average delivery cost of a letter to a DP post box and to a big customer was also given and these were only 20-28 per cent of the cost of deliveries generally. Unfortunately the cost information supplied by DP was inadequate to enable to estimate DP's delivery burden, if any.

At interview we were informed that DP had estimated its parcel delivery burden, and at the EC's workshop on 25 June 1998 DP said that this information would in due course be made public. In respect of further cost information connected with NERA's work, DP informed us that senior management had decided that this should not be made available.

Saturday deliveries of letters and parcels. We were told that these are extremely uneconomic. Competitors in the private sector, we were informed, either do not offer deliveries on Saturdays or charge rates that are several times higher than their normal weekday rates. DP has estimated the net avoidable of Saturday deliveries, but to date have not made the results of this exercise available to NERA.

The number of post office counters. Again, we were told that the existing network is too large. DP would like to reduce the total and to convert part of the network into agencies.

¹²⁵ Ministry and regulator questionnaire, p6.

However, doing so was meeting union resistance. Making staff savings is difficult because most employees have civil service status and therefore effectively are guaranteed employment for life. Even those employees who are not civil servants¹²⁶ earn considerable security after a number of years service.

Rates of pay. We have no information from DP on hourly rates of pay for postal workers. We were informed that these, together with the cost of holiday and pension entitlements, made them considerably higher than the market rates. The annual report, 1996, refers to non-capitalised pension liabilities of about DM30 billion.¹²⁷

¹²⁶ Angestellte as opposed to Beamte.

¹²⁷ DP. *Jahresbericht 1996*, note (9), pp65-66.

C.7. Greece

C.7.1 Introduction

Table C.13
Greece - Basic Statistics

	1992	1993	1994	1995	1996
Area of territory (square kms)	131626	131626	131626	131626	131626
Population (thousands)	10295	10349	10410	10443	10465
Population density (people/km ²)	78.21	78.62	79.09	79.34	79.51
EL.TA employees	11009	10926	11368	11572	11520
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	4.5	4.5	4.5	4.5	4.5
Number of households without postal delivery	0	0	0	0	0
Number of delivery points (million)	n.a.	n.a.	n.a.	n.a.	3.204
Letter mail service (millions of items delivered)	411.802	410.206	428.201	440.141	465.173
Number of post offices	934	947	955	959	963
Revenue (million drachmas)	38146	48010	54442	63646	78550
Operating costs (million drachmas)	55138	58715	71367	82285	92514
Operating profit/(loss) (million drachmas) *	16991	10704	16925	18638	13964

Source: Eurostats Demographic Statistics 1997; EL.TA Annual Reports 1995 and 1996 (in Greek); UPU Postal Statistics, 1996.

Notes: EL.TA employees include small number of part-time staff. 1992 losses and half of 1993 losses were covered by OTE (the Greek PTT).

Postal services in Greece are provided by Hellenic Posts (EL.TA). According to the Law n/70 - 496 of 28th March 1970 on the organisation of the Postal Enterprise, EL.TA operates as a Legal Person of Private Law.

The Ministerial body responsible for postal matters is the General Secretariat for Communications in the Ministry for Transport and Communications. The relationship between the Ministry and EL.TA derives from a range of Laws and Decrees. The most important of these are:

- Law n/70 - 496 of 28th March 1970, which deals with the organisation of EL.TA, and which entered into force on 1st May 1970. Decree n/75 - 277 of 29th April 1975 extends the validity of the 1970 Law beyond 30th April 1975;
- Law n/71 - 1063 of 1971 on the issue of stamps;
- Decree n/86 - 295 of 26th August 1986 on the structure, role and mode of management of EL.TA;

- Decree n/92 - 149 of 8th May 1992 on the organisation of the Ministry for Transport and Communication; and
- Law n/96 - 2414 of 25th June 1996 on the modernisation of public enterprises and organisations.

The Ministry is responsible for inspecting and supervising EL.TA. In regard to financial matters, it does this in co-operation with the Ministry for Finance and the Ministry for National Economy. The Ministry, in conjunction with these other two Ministries, approves EL.TA's Strategic Plan, and its Business Plan, as well as the Contract for Management which is still under development. The President of the Board of Directors of EL.TA., the Chief Executive Officer (CEO) of EL.TA and the three State's representatives are appointed following a common decision by the Ministry for National Economy, the Ministry for Finance and the Ministry for Transport and Communication. The five shareholders' representatives are elected by the General Meeting of Shareholders, two representatives of the EL.TA staff are elected through a direct and general voting process; finally, one person is appointed from the Social and Economic Committee.

C.7.2 Definition of Universal Service Obligation

Neither current legislation, nor memoranda, licences or agreements, specifically define USOs in Greek postal services at present, though various documents deal with the general obligation to provide postal services, in particular:

- The Presidential Decree of 21st September 1935, which states that "the right for using the postal service is recognised to everybody";
- The Ministerial Decision n/88 - 94989 of September 26th 1988, which states that "the organisation of EL.TA has the mission to organise, exploit and develop the Postal Offices network across the whole Greek territory and to provide, through these offices, postal services, as well as to perform any other task related to the nature of the Post"; and
- The Charter of Obligations to the Customer (Ministerial Decision n/98 - 82746 of 15th January 1998).

EL.TA provides a service to the whole of Greece at a uniform tariff.

In addition, EL.TA provides a special tariff for the transport of newspapers and other press material, and is re-imbursed for this by the Ministry for Press. Figures supplied are of 8,898 million drachmas in 1996 but only 7 million drachmas in 1997.

As well as this and material for the blind, EL.TA has a written obligation to provide mail for the armed services, and other governmental service mail. The relevant law for the blind is

the Ministerial Decision n/94 - 73302 of 26 August 1994 on the postal fee exemption for the blind.

Neither the Ministry, nor EL.TA, have made estimates of the costs of USOs in Greece, though EL.TA believes that their USO cost is likely to be highest for parcels, and then for letter mail. In the hypothetical instance that they were not faced with USOs, they would adjust tariffs to cover average costs of services, and cease to provide loss-generating services.

C.7.3 Reserved Services

In regard to reserved services in Greece, these are covered by Law n/30 - 4581 of 30th April 1930 on postal correspondence, and the Decree of 21st September 1935. Article 1, chapter A', of the 1930 Law states that: "... the Postal Administration of the State has the exclusive right in the transportation of:

- open or closed letters;
- short letters;
- postcards."

Exemptions to these reserved items are:

- mail delivered in the same city's territory by an individual (for his own interest), or by persons in his/her service;
- up to five open letters (e.g. references) transported by an individual himself;
- public administration documents transported by other officially predefined ways; and
- official dispatches concerning public transport enterprises (railway, shipping, air carriers) which are circulated by the enterprises' facilities.

There are no other memoranda, licences nor agreements that specifically define **reserved** postal services.

C.7.4 Actual Service Provision

As noted above there is no written USO in Greece. In practice, mail is delivered five days a week in most areas. In urban areas, which account for three-quarters of all mail deliveries, mail is delivered five times a week in all areas. In the remaining rural areas, mail is delivered five times a week in three-quarters of the rural areas, four times a week in about 7.5 per cent of the rural areas, three times a week in about 12.5 per cent of the areas, twice a week in 4.5 per cent, and once a week in the remaining 0.5 per cent of rural areas.

In urban areas, mail is collected twice a day from public street mailboxes, and five times a day from Post Office mailboxes. In rural areas, the postmen also collect mail, so the frequency of collection in each rural area is the same as the frequency of delivery in that area.

There is a uniform tariff in operation in Greece, but no definition of "affordable" tariffs.

Whether delivery of letter mail takes place to the addressee's door is an operational matter for EL.TA, and is determined by an internal document on *Guidance on the delivery for rural and urban areas*. There are no data on the proportion of mail or addresses that get delivery to their door and the addresses that get no delivery at all.

Parcels are delivered to the addressee's door in district capitals, and provided they are "home delivery" parcels. There is a premium paid of 450 drachmas per parcel for this service, or 400 drachmas in the case of grouped delivery (over 20 parcels). In other areas, the recipient of the parcel will be advised to pick up the parcel from a Post Office counter.

Targets for speed of delivery for letter mail are defined in the Charter of Obligations to the Customer (see above, Section C.7.2). This states that first priority items should normally be delivered next working day, and second priority items by the third working day after posting. EL.TA estimates that, in 1997, 37.7 per cent of items were delivered by the next working day, but no detailed quality control procedures are used to assess actual performance.

There are no specified quality-of-service targets for parcel mail, and no data on actual performance.

C.7.5 Regulatory Responsibilities

There is at present no established postal regulatory body in Greece, and the Ministry of Transport and Communications is responsible for supervising EL.TA and for decisions on tariffs and investments. Revisions of tariffs in the reserved sector, which in recent years have taken place approximately once every two years, are decided by EL.TA's Board of Directors and approved by the Ministry of Transport and Communications. Before providing its final approval, the Ministry must check with the Ministry of National Economy as to whether the changes are consistent with the Government's financial policy. Once approved by the Ministry of Transport and Communications, the revised tariffs are published in the Government Gazette.

C.7.6 Post Office Counters

EL.TA has 1,036 post offices and in addition there are 260 agency counters, which are generally smaller and in rural areas.

EL.TA estimates that there are 762 unprofitable post offices in Greece, and that the average annual loss from each of these is 20 million drachmas. This gives a total loss from unprofitable counters of 15.3 billion drachmas. However, not all of these losses are associated with postal business, which accounts for 79 per cent of mark-ups. This remaining 21 per cent is associated with money transmission and banking transactions, and with social security and other government transactions.

According to the Ministry, EL.TA has autonomy in determining whether to close post offices, though the Ministry approves opening of new offices.

C.7.7 Costs and USO burdens

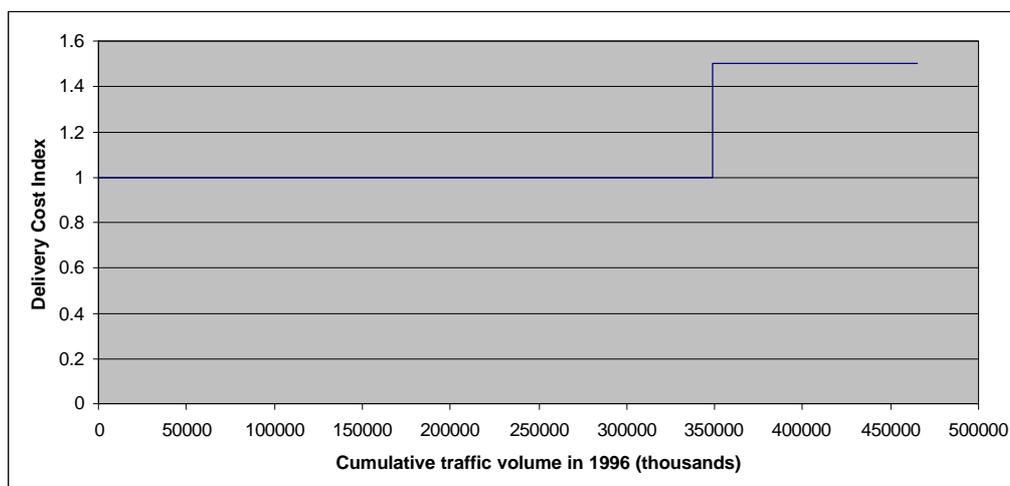
EL.TA were able to provide data on the split of their costs between different activities (collection, sorting, transport, delivery and overheads), separately for both letters and parcels businesses. This information is shown in Table C.14.

Table C.14
Cost Proportions for ELTA

	Letters (Mail up to 2kg)	Parcels
Collection	13	18
Sorting	31	30
Transport	5	9
Delivery	48	40
Unallocated overheads	3	3
TOTAL	100	100

Although EL.TA were not able to supply detailed information on delivery costs, they believe that delivery costs per item in rural areas are about 50 per cent greater than those in urban areas. Seventy-five per cent of mail is delivered in urban areas. Since the total volume of mail delivered was known, it was possible to construct a rough delivery cost index schedule using the information on the proportions of the rural and urban deliveries and their relative costs, which is shown below in Figure C.5

Figure C.5
Delivery Cost Index for Greece



In order to calculate USO burdens, we assessed avoidability of costs other than delivery using cost elasticities for different functions. Since we did not have direct evidence from Greece, we based these on econometric estimates from other countries, and used values of 0.05 for collection, 0.8 for both inward and outward sorting, and 0.3 for transport.¹²⁸ These values imply that if traffic is withdrawn from the network, a ten per cent fall in traffic would in the long run lead to a one half per cent fall in collection costs, an eight per cent fall in sorting costs and a three per cent fall in transport costs.

Greek postal services do not break even, so we estimated USO burdens on the basis of an average price equal to average cost. Under these various assumptions, our model estimated the burden of the USO for letter mail in Greece, on a fully distributed cost basis, as 2,253 million drachmas in 1996. On an avoidable cost basis our estimate is zero. The estimate of 2,253 million drachmas for the USO burden on a fully-allocated basis represents 4.7 per cent of EL TA's letter mail turnover in 1996.

¹²⁸ We assume no changes in unallocated costs when traffics change.

C.8. Ireland

C.8.1 Introduction

Table C.15
Ireland - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996	1997
Area of territory (square kms)	68895	68895	68895	68895	68895	68895	68895	68895
Population (thousands)	3507	3521	3546.6	3567.3	3580.2	3594.7	3615.6	
Population density (people/km ²)	50.9	51.1	51.5	51.8	52.0	52.2	52.5	
An Post employees (end year)	7840	7608	8180	8532	8101	8025	8110	8445
Postmasters engaged as agents (end year)	1951	1928	1907	1876	1854	1838	1825	1818
Employees plus postmasters (end year)	9791	9536	10087	10408	9955	9863	9935	10263
Average number of deliveries per day in urban areas	1	1	1	1	1	1	1	1
Average number of deliveries per week in rural areas	5	5	5	5	5	5	5	5
Number of households without postal delivery	0	0	0	0	0	0	0	0
Number of delivery points (million)	1.17	1.144	1.144	1.178	1.208	1.232	1.261	1.296
Letter mail service (millions of items delivered)	482	494.1	483.5	518.1	551.7	559.8	578	646.6
Number of post offices	2046	2023	2002	1971	1949	1934	1921	1917
Company post offices	95	95	95	95	95	96	96	99
Sub-post offices	1951	1928	1907	1876	1854	1838	1825	1818
Revenue (£ million)	214.5	232.9	243.6	280.3	298	306.8	330.9	368.7
Operating costs (£ million)	224.3	235.9	243.9	273	287.1	297.8	319.1	354.8
Operating profit/(loss) (£ million)	-9.8	-2.9	-0.3	7.3	10.9	9	11.8	13.9

Source: Eurostats Demographic Statistics 1997, An Post Annual Reports 1994 and 1997, UPU Postal Statistics 1996

Postal services in the Republic of Ireland are provided by An Post. The sponsoring ministry is the Department of Public Enterprise.

C.8.2 Definition of universal service obligation

The USO in Ireland is defined in Sections 12 and 13 of the Postal and Telecommunications Services Act, 1983 and in the Memorandum and Articles of Association of the Company 1983. The main obligations as set out by the Act are:

- to provide a national postal service (from Section 12);

- to satisfy all reasonable demands for comprehensive and efficient postal services (from Section 12);
- to provide services by which money may be remitted (from Section 12);
- to provide counter services (from Section 12);
- to ensure that charges for services are kept at the minimum rates consistent with meeting approved financial targets (from Section 13); and
- to ensure that revenues of the company are sufficient to meeting all charges on the revenue account (including depreciation of assets and allocation to general reserve), to generate a reasonable proportion of capital needs and to remunerate capital and repay borrowings (from Section 13).

In addition to these, An Post commits itself through the Memorandum

- "[t]o convey, receive, collect, send, forward, deliver, hold for delivery or collection, despatch, carry messages, letters, postcards, reply cards, newspapers, book patterns, parcels, sample packets and every postal packet (including circulars, invoices, cheques), parcel, packet or article transmissible by post whether by land, sea or air or through other message transmitting technologies, whether to, from or within the State." (Art. 6)
- "To provide and carry on a courier service being a service that provides for the acceptance, collection and delivery of any article or any communication or other thing within or outside the State and kindred services." (Art. 9)

Neither the Act nor the Memorandum give any details regarding the frequency or speed of delivery. Regarding the location of delivery, the Act specifies that the company need not deliver a "postal packet" to the addressee's residence or office, provided it makes acceptable alternative arrangements to make it available to the addressee (cf. Art. 65).

While specific user groups are not specified as part of the USO, there is a provision (Art. 74) which allows for free postage in connection with any election or referendum. However, An Post is entitled to be fully reimbursed for these expenses under Art. 75.

C.8.3 Reserved services

The Act specifies that

- "The [postal] company shall, subject to the provisions of this section, have the exclusive privilege in respect of the conveyance of postal packets^[129] within, to and

¹²⁹ Note that a "postal packet" includes letters but does not refer to a telegram, a newspaper or a parcel.

from the State and the offering and performance of the services of receiving, collecting, despatching and delivering postal packets." (Art. 63)

This privilege is granted as a *quid pro quo* for its obligation to keep the charges for services at a minimum, given the financial constraints which must be met¹³⁰. The Act explicitly recognises that cross-subsidisation of some loss-making by profit-making services will occur.

The Ministry regards ubiquity as immensely valuable to An Post and, hence, feels that "unfair burden" is not relevant to describe the cost of the USO. The benefits derived from a reserved area for letter services are seen as two-fold: reputation and infrastructure. An Post has an excellent reputation throughout the country and benefits from its points of presence across the country. As a result of these, many companies are trying to market and distribute their products via An Post to take advantage of both its reputation and geographic infrastructure.¹³¹

C.8.4 Actual service provision

Concerning delivery of postal items, there is one daily delivery from Monday to Friday. For businesses located in business districts, this is effected before 9.30 am, while all other deliveries take place before 2.30 pm.

Collection varies between Dublin and the Provinces. In Dublin, there are general collections which take place at 11 am and at 5.30 pm daily, with selected collections occurring at 2.30 pm, 4 pm and at 10.30 pm. Weekend collections take place from post offices and main urban centres only.

In the Provinces, daily collections from Monday to Friday comply with the stated latest time for posting items. Additional collections are effected from frequently used locations. Weekend collections occur from post offices and main urban locations.

The quality of service has been assessed since 1988/89. Service monitoring data, summarised in the 1996 Annual Report, shows that 92 percentage of items were delivered on the day following that of posting if posted before the latest posting time. Within this overall figure, individual mail streams also met the target with the exception of mail posted within Dublin destined for the provinces which only reached a figure of 83 percentage. In 1997, the overall figure was 93 percentage. These overall figures met the internal target set at 90 percentage. These figures all relate to standard size letters with a typed address. A new monitoring system now assesses the performance of all mail.

¹³⁰ As specified by Section 13 of the Act.

¹³¹ An Post argues that this relates to the 1,000 countries (out of a total of around 2,000) that are automated, and not to the delivery service itself.

An Post is bound by the Memorandum to deliver and collect every postal packet within the State¹³². While there are no written obligations to deliver to the addressee's door, the postal administration feels bound by an unwritten obligation. As noted above, if the postal administration does not deliver to a residence, it is bound by Art. 65 of the Act to make acceptable alternative arrangements in order to make it available to the addressee. In total, 1.296 million addresses were served by delivery direct to the door in 1997.

Some 5,000 addresses in rural Ireland have their mail delivered to road-side boxes as part of a voluntary trial scheme. Households with more difficult access may be approached and asked if they will accept delivery to a roadside box. If they agree, they have to pay for the box. The provisions of section 65 of the Act have never been legally tested in order to test the validity of criteria for siting a road-side box.

C.8.5 Regulatory responsibility

An Post has responsibility for most decisions such as those affecting investment, the return on capital, standards of service,¹³³ and the numbers of post offices. However, the Ministry must approve tariff changes for postal packets, according to Art. 70(2). There are no specific criteria to assess "affordability" as used in the Postal Directive 97/67/EC.

The tasks of the Ministry include:

1. Approval of the Memorandum;
2. Appointment of the Board of An Post;
3. Issue to An Post of directions relating to government policy decisions;
4. Licensing for postal services;
5. Legal power to stipulate financial targets to be achieved by An Post;
6. Approval of certain borrowing by An Post; and
7. Present of Annual Reports of An Post to Parliament.

These are anchored in Art. 110 of the Act which specifies the functions of the Ministry. While these are legal powers, in practice, recourse to these is rare. Financial targets have not, so far, been set by the Ministry which prefers to take a light-handed approach to regulation. There is some dispute about the nature of the provision concerning the directions issued to An Post with regard to government policy decisions. The Ministry argues that, at least legally, it could invoke Art. 110 (1) to put flesh to the bones of Art. 12 where the USO is defined

¹³² By Section 6 of the Memorandum, also quoted previously (see p.1).

¹³³ Though in practice the Ministry has some influence on service standards.

somewhat vaguely¹³⁴. However, in practice, the Irish approach has always been to settle differences of this nature on a strictly informal basis.

Since the last price increase in April 1991, there has been only one change in the tariff for letters, in April 1998, which was revised downwards by the Ministry. The main feature of this tariff change was to produce a single stream which abolished the unsealed printed paper rate of 28p and combined it with the standard rate which had previously been 32p. An Post wished to set this new uniform rate at 31p but the Ministry revised it to 30p.

In 1996, the Ministry did not authorise an application by An Post to increase the tariff for items in the 0.5 to 1 kg range by 25 percentage from IR£2.40 to IR£3.00.

The criterion for tariff changes in 1990 and 1991 was revenue generation while in 1998, customer and operational criteria were the underlying features. An Post is constrained by the need to meet the financial targets as specified in Art. 13 of the Act¹³⁵. In the case of the recent tariff restructuring, the company was content to keep nominal profits constant. Volumes have been on the increase¹³⁶ and costs are being kept down, despite wage increases, mainly due to efficiency savings (especially automation). Since the 1991 price change, the real cost of posting a letter has been significantly reduced in the light of a 15.4 per cent increase in the consumer price index over the period.

Ministerial approval of tariff changes for parcel services is not needed as this market is open to competition. The postal administration advises the Ministry annually on the pricing of parcels.

In practice, the Irish system functions according to unwritten or informal rules. For example, while the postal administration takes decisions on the number of post offices they operate, the postal administration perceives an unwritten constraint to keep many, largely unprofitable post offices open. Since 1984 when An Post was incorporated, only three hundred of the 2200 post offices inherited were closed down, mainly through natural attrition¹³⁷. An Post estimates that some one thousand offices do around 90 per cent of the work.

Another "inherited" obligation relates to the number of deliveries and the quality of service provided. Equally, an unwritten obligation relating to delivery to an addressee's door is perceived by An Post as a binding if unwritten restraint. In the event of a proposed change in this policy, An Post would expect ministerial intervention to prevent such a change.

¹³⁴ Art. 110(1) stipulates that the Minister has the right to "issue direction" to An Post in the area of general policy decisions.

¹³⁵ Previously quoted (see p.1).

¹³⁶ The 1996 Annual Report estimates annual volume growth in core letters of 6.5%.

¹³⁷ For example, when the post master or mistress of the local office retired.

Although there is no explicit requirement on An Post to charge a uniform tariff across all geographical locations, uniform tariffs are taken to be another unwritten requirement. An Post does provide discounts for pre-sorting and early presentation of postal items to a post office before a prescribed time of day. There are no tariff concessions for any user groups with the exception of Braille items for the blind and books destined overseas, both of which are subject to UPU guidelines.

The criteria for selecting sites for collection boxes are mainly inherited. There is a small demand-driven component if a new housing unit is set up, for example. The standard which is always adhered to is that there is a box at every post office. While some rural collection boxes are not heavily used, they equally do not impose a large cost burden as they can be combined with delivery and have early collection times which fit in with the postal delivery round.

C.8.6 Costs and USO burdens

C.8.6.1. Universal service

An Post supplied data on the division of costs over different functions for letter mail and parcels separately. These are shown in Table C.16.

Table C.16
Cost Proportions for An Post

Proportions of costs (in per cent) for:	Letters (mail up to 2 kg)	Parcels
Collection/clearance	12	10
Outward sorting	18	25
Trunking/transport	7	15
Inward sorting	6	10
Delivery	57	40
Overhead costs not included in the above	Allocated	Allocated
TOTAL	100	100

These figures are based on actual analyses of An Post costs. According to An Post, collection and transport costs are unlikely to vary with volume declines, although no data are available. Manual sorting costs are likely to vary with volume in the medium-term. Automated sorting costs are only variable in the long-term, but again, no data are available.

Although there have not been any direct attempts to estimate the costs of the USO in Ireland, An Post believes that by far the largest cost is incurred from deliveries to sparse postal areas for both letter post and for parcels, followed by the cost of letter and parcel collections from these areas. This is particularly significant in the light of Ireland's demographic structure which is characterised by a high population density in Dublin and a very low density outside the capital.

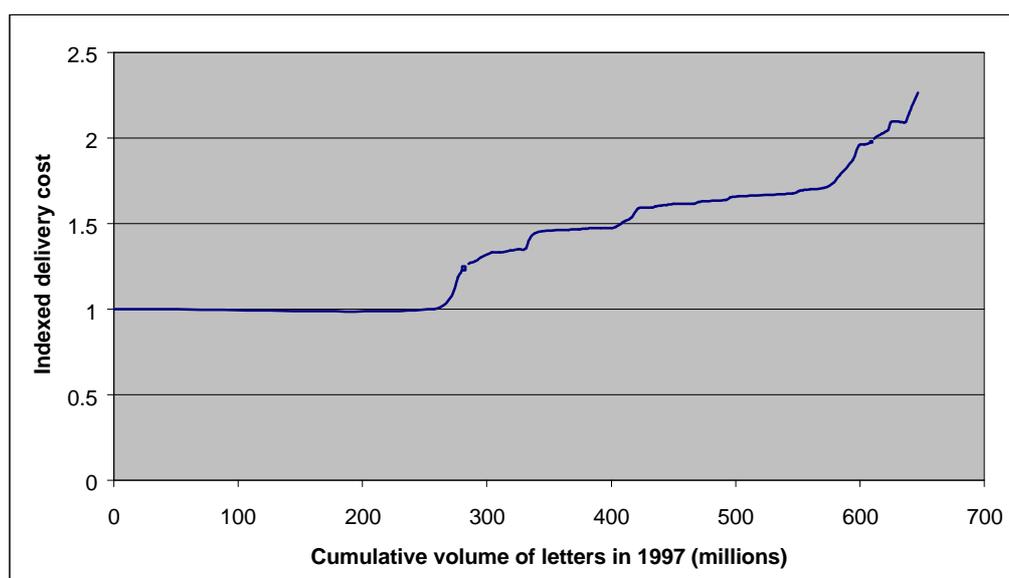
There are 50 Head Post Offices in Ireland, grouped into seven planned new regional areas: Cork, Dublin, Galway, Limerick, Mullingar, Portlaoise and Sligo. For each of the 50 HPOs, An Post supplied data on:

- total labour costs, in the form of Operations Pay, for 1997.
- the split of these costs into functions: collection, outward sorting, transport, inward sorting, delivery; and
- total numbers of residential addresses and business addresses.

In addition, data for a new system for sampling mail flows in order to assess quality-of-service performance, supplied by An Post, shows estimates of the proportions of mail delivered in each of the seven regions. We divided An Post's total 1997 volume of items into estimates of mail delivered in each of these regions, and then further split these mail volumes into our estimates of the mail delivered in each of the 50 HPO areas, on the basis of numbers of business and residential addresses in each area, and the overall ratio of business to residential mail in Ireland.

We were then able to calculate a delivery cost index for Ireland by dividing labour costs in each of the 50 areas by our estimate of mail delivered in each area. The resulting index is shown in Figure C.6. Delivery cost per item is lowest in Dublin, with deliveries in Dublin representing 40 per cent of the total mail in Ireland. This is reflected in the long flat section on the left-hand side of Figure C.6.

Figure C.6
Delivery Cost Index for Ireland



In order to calculate USO costs, we assessed avoidability of costs other than delivery using cost elasticities for different functions. Since we did not have direct evidence from Ireland,

we based these on econometric estimates from other countries, and used values of 0.05 for collection, 0.8 for both inward and outward sorting, and 0.3 for transport.¹³⁸ These values imply that if traffic is withdrawn from the network, a ten per cent fall in traffic would in the long run lead to a one half per cent fall in collection costs, an eight per cent fall in sorting costs and a three per cent fall in transport costs.

Under these assumptions, our model estimated the cost of the USO for letter mail in the Republic of Ireland, on a fully distributed cost basis, as Ir£ 11.9 million in 1997, and, on an avoidable cost basis, of only Ir£ 0.6 million. The latter figure represents the amount over the price of the services that would be saved if the "unprofitable" part of the service were withdrawn. It is clearly sensitive to the particular avoidability assumptions made. Our estimate of Ir£ 11.9 million for the USO cost on a fully-allocated basis represents 5.4 per cent of An Post's letter mail turnover in 1997.

C.8.6.2. Counters

A Viability Plan in 1990/91 considered a number of cost reduction measures. Two subsequent years of industrial disputes led to a modified plan which introduced single delivery in all areas, as well as a move from rail- to road-based distribution and the construction of a new fully-automated centre in Dublin for distribution and delivery. The original plan had considered potential reductions in net cost as a result of a number of policies. These included the plan for the automated sorting office in Dublin, single delivery in both Dublin and the provinces, the switch from rail to road, a switch from delivery to the door to delivery to a postbox at the end of the drive in rural areas, centralisation of payroll, and rationalisation of sub post offices. This last strategy of closing the 554 most unprofitable counter offices¹³⁹ was estimated as likely to lead to an annual saving of £1.8 million Irish pounds each year, once transitional costs had been incurred in 1990 and 1991. In the event, political opposition led to abandonment of this part of the Viability Plan.

¹³⁸ We assume no changes in unallocated costs when traffics change.

¹³⁹ The total number of sub-offices in 1990 was 1951. Of the 554 offices proposed for closure, 28 were in Dublin, 48 in other towns, and the rest were rural.

C.9. Italy

C.9.1 Introduction

Table C.17
Italy - Basic Statistics

	1992	1993	1994	1995	1996
Area of territory (square kms)	301316.2	301316.2	301316.2	301316.2	301316.2
Population (thousands)	56757.2	56960.3	57138.5	57268.6	57333
Population density (people/km ²)	188.4	189.0	189.6	190.1	190.3
Total number of staff	226,643	221,534	n/a	203,126	n/a
Average number of deliveries per week in all areas	1	n/a	n/a	1	1
Average number of deliveries per week in rural areas	6	n/a	n/a	6	6
Number of households without postal delivery	0	n/a	n/a	0	0
Number of letter-post items (domestic service) in mio	6,883.60	6,617.00	n/a	5,354.10	6,237
Number of letter-post items (international service dispatch)	292.8	147	n/a	156.8	146.6
Number of letter-post items (international service receipt)	535.4	165.6	n/a	180.5	200.7
Number of post offices	14,411	14,377	n/a	14,142	n/a
Revenue (Lit. bn)	4.8907	4.1298	n/a	4.8021	5.3494
Operating costs (Lit. bn)	6.6221	5.6308	n/a	5.3602	5.8899
Operating profit/(loss) (Lit. bn)	0.3497	0.3195	n/a	n/a	n/a

Sources: Eurostats Demographic Statistics 1997; UPU Postal Statistics 1996

C.9.2 Definition of the Universal Service Obligation

C.9.2.1. Primary or secondary legislation

There are two pieces of legislation which define the Italian USO but they both refer to the public administration "Amministrazione delle Poste e delle Telecomunicazioni" which no longer exists in that organisational and legal form. These are (1) DPR of 29 March 1973, N. 156 concerning postal services, postal savings and telecommunications and (2) DPR of 29 May 1982, N. 655 which contains rules for the delivery of postal services (specifically letters and packages). According to the Ministry, the norms are obsolete in that they are neither demand-oriented nor harmonised with the new EU Directive N. 97/67/CE on Postal Services.

Since 1994 (Law N.71 of 29 January 1994), the public administration has been transformed into a state-owned enterprise "Ente Poste Italiane" (EPI) with a mandate to manage postal services and "bancoposta" or financial post services. Regulatory oversight of this operation was given to the Ministry for Communications.

The new enterprise "Poste Italiane SPA" (PI) has continued to carry out the services previously carried out by the state-owned enterprise. However, due to the transformation the norms which regulate postal service delivery (and hence, the USO) have suffered progressive dismantling. For example, the mandate to contract out some reserved postal services to an outside agent, given to directors of provincial post offices by Art. 29 of Law DPR N. 165/73, has now been transferred to the Ministry of Communications, the postal regulatory body (see Section C.9.10.3).

National regulations also allow for the contracting out of parts of the reserved area to private companies, namely within the precincts of regional capitals, without imposing any USO on these. Italy is the only country within the European Union which follows this practice.

C.9.2.2. Memoranda, licences or agreements

The "Contratto di Programma" (CDP) defines the relationship between the regulator and the postal administration. This contract contains a list of the public services and related quality of service targets, the fulfilment of which are the obligation of PI. Taking into account the performance of other postal administrations in the EU, the Italian postal administration obligations with respect to services to be offered are set out specifically in Art.1, c.3, c.4 and c.5 of the CDP.

PI undertakes, by Art. 1, c.3 of the CDP, to deliver universal and reserved services concerning all ordinary, registered and recorded correspondence, as well as correspondence authenticated or certified in any form, telegrams, telex or public data transmission carried out on through the post office network and all services related to certification, authentication and protection.

In addition, based on Art. 1, c.4, PI undertakes the delivery of services - to be considered universal - relating to the collection and distribution of packages up to 20 kg.

Art. 1, c.5 of the CDP relates to services which are neither universal nor reserved and, hence, competitive.

It should be noted that the CDP agreement with the then Ministry of Posts and Telecommunications on 17 January 1995 has since expired (on 31 December 1996) and is expected to be revised.

The drawing up of a new CDP which defines the USOs imposed on PI is envisaged by primary legislation (Law N.662/96, Art. 2 c. 23) and secondary legislation (Decision of the Interministerial Committee for Economic Planning of 18 December 1997, especially Art. 5 of the document which refers to the transformation of EPI into the shareholding PI).

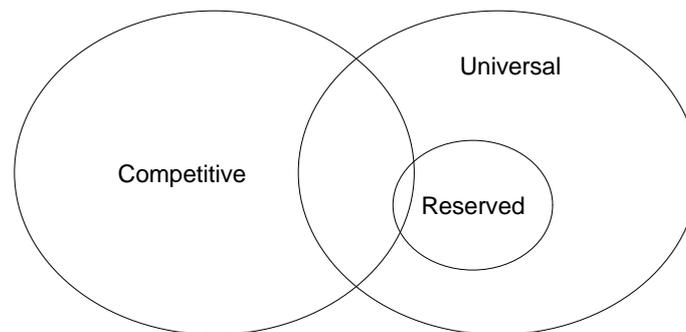
In general, these matters will be subordinated to the new EC Directive No. 97/67/CE and the definition of the USO provided by the new CDP will have to be consistent with the definition provided by the new Directive.

C.9.3 Reserved Services

C.9.3.1. Primary or secondary legislation

There are three types of services, reserved (R), universal (U) and competitive (C) ones. Reserved services form a subset of universal services. Some universal services are also competitive. Due to the presence of private delivery agencies (Section C.9.10.3), there is a small intersection between reserved and competitive services. The following diagram illustrates the relationship between these three categories:

Figure C.7
Types of Postal Services in Italy



DPR N. 156/73, and its successive modifications, specifies in Art. 1, c.1 that the following services belong exclusively to the State, within the limits specified by this Decree:

- Services of collection, transport and distribution of "epistolary correspondence" (i.e. letters); and
- Certain telecommunications services, namely telegrams and telex services.

DPR No. 655/82, Art. 24 defines "epistolary correspondence" as any closed mail, with the exception of packages and any open mail which contains communications of current or personal character.

This means that the reserved area is defined by relevant legislation based not on criteria of weight or price, but based on the type of mail. The public administration presides over exclusive right in the entire area of epistolary correspondence, regardless of weight or price.

Exceptions to the reserved area are specified in DPR 156/73, specifically Art. 41 of the second book, Title II, Heading I. These include standard exceptions such as, for example, non-profit letter delivery by private persons. Notably, however, it includes "collection,

transport and delivery of letters in areas and on days where postal services are not working" within the limits specified by the relevant regulation. This provides the justification for the so-called "agenzie di ricapito" (AdRs) or delivery agencies (Section C.9.10.3). This procedure is allowed only in times of "emergency", defined as times when the public service is not efficient enough in certain areas to carry out local deliveries, i.e. in peak periods. In these cases, authorisation is granted to private or other companies to deliver mail locally, within the reserved area.

C.9.3.2. *Memoranda, licences or agreements*

By Art. 1, c.3 of the CDP, the following services are considered to be universal and reserved: all ordinary, registered and recorded correspondence, as well as correspondence authenticated or certified in any form, telegrams, telex or public data transmission carried out by the network of post offices and all services related to certification, authentication and protection.

C.9.4 Regulatory Responsibility

While the Ministry of Communications has no influence on the price of products in competitive markets, it has the right to set discounted tariffs for

- Books;
- Newspapers and periodicals published by members of the national press register;
- Publications with information about national and local enterprises, associations and non-profit organisations,

even if these products are operating in liberalised markets. This is based on Law No. 662/96, Art. 2, c.19 and c.20, stipulating that in doing so, the Ministry would take into account the exigencies of consumers and demand characteristics as well as the development of traffic volumes. The postal administration considers itself to have little influence in setting these tariffs.

In the reserved area, the new mechanism for fixing tariffs will be based on the price cap method. The new CDP will define the details for the methodology to be applied for setting tariffs. The new regime is based on Art. 2, c.22, which gave the *Nucleo di consulenza per la regolazione dei servizi di pubblica utilità*, otherwise known as NARS - a consultative body - the task of proposing a new tariff structure for reserved postal services (in accordance with both the Ministry and PI) before 31 January 1997. The method of tariff adjustment stipulated approximated efficient levels of production costs for postal services.

The Ministry shares responsibility over the standards of service and the number of post offices with the postal administration.

The postal administration presides over both prices of products in competitive markets and investments and over the prerogative of setting the return on capital. It also sets the level of losses which are reimbursed by the Ministry of Finance.

C.9.5 Actual Service Provision

C.9.5.1. Delivery

Through internal regulations stemming from the time when the postal administration had not yet been transformed into a shareholding and hence also had no service obligation to third parties, the USO specifies the frequency of delivery. The obligation encompasses one daily delivery on six days per week.

Actual delivery takes place once a day to every domicile (of all physical and legal persons) on six days a week, including Saturday. Deliveries usually reach their destination during the morning hours.

The USO also defines the minimum speed of delivery. There is only one level of service with standards referring to the speed of delivery defined by the CDP. Eighty-five per cent of urban (city to city) deliveries must reach their destinations within one day of posting (J+1). For the rest of the mail, 85 per cent should reach its destination within two days of posting (J+2). As of next year, mail will be divided into two levels of service, priority and non-priority items, defined by their different speeds of delivery.

Concerning actual speed of delivery, 64 per cent of inter-urban deliveries reached their destinations within one day of posting and 87.3 per cent within two days of posting. For the remainder of national mail, 67 per cent reached its destination within two days and 85 per cent within three days of posting.

The postal administration is bound by written obligations to deliver to the addressee's door (in the case of registered or recorded correspondence), to boxes at the end of drives, to groups of boxes (e.g. in apartment blocs) and to grouped post office boxes.

Currently, the total number of addresses delivered to comprises 51 million, of which 27 million are domiciles and 23 million are commercial organisations. There are other 37 million so-called "potential delivery points" which correspond to uninhabited domiciles.

Whilst there is always the obligation to delivery to all addresses, there are exceptions to this rule, for example, isolated habitations which cannot be reached or are connected to roads which cannot be accessed by motorised means or by bicycle. In this case, delivery can be forthcoming either at the local post office or in grouped boxes at the end of the "drive".

There is no difference in actual frequency of delivery to either business or residential addresses nor to densely or sparsely populated areas. All addresses in all areas receive one delivery a day (on six days) with the exception of isolated habitations.

C.9.5.2. Collection

Through internal regulations, the USO also specifies the frequency of collection. This is set as one daily collection before 5 p.m. in urban areas and before 12 noon in the provinces. This standard is equally met.

C.9.6 Parcels (packages) up to 10kg (30kg)

The process of parcel collection and clearance involves accepting the parcel in a post office or, in the case of large users, directly at the workplace. Pick up from large users is currently being considered.

The USO requires PI to deliver parcels to the addressee's door. The total number of addresses to which parcels are delivered to is 51 million plus 37 million potential delivery points.

The USO equally imposes the speed of delivery, namely that 85 per cent of parcels in this category should be delivered within five days of mailing. This is based on Art.3 c.1 of the CDP. This standard is not met in actual terms. Only 77.15 per cent of mail in this category reaches its destination in J+5 while 85.29 per cent reaches its destination in J+6.

PI believe that parcel collection costs would not change with changing traffic volumes. This has been confirmed in a study undertaken in 1996 (see also Section C.9.8.3). The costs of sorting are also considered to be inelastic to changing traffic volumes. This is mainly because 80 per cent of parcels are handled by automated machinery. For the remaining 20 per cent handled manually, the relationship between sorting costs and changing traffic volumes is considered to be more sensitive. Transport costs are taken to be inelastic vis-à-vis traffic volumes.

C.9.7 Counters

There are 14,400 post office counters in total, all of which are owned and managed by the postal administration. While there are currently no agency counters, the 1998 Financial Law (N. 449/97) requests that the postal administration be permitted through the new CDP to contract out counter services in certain areas, even on a temporary basis only. The areas specified for this are small communities situated in the mountains. Art. 53 c.4 of this Law provides for counter services to be contracted out either to public or private entities already involved in commercial or operational activities or who intend to operate in these geographical areas.

DPR 1417/67 defines the requirements and necessary procedures for the opening and closing of postal counters. Concerning opening hours and/or days, this is determined by PI who undertakes, in Art. 4, c.2 of the CDP to gradually extend the hours of opening of post offices in order to significantly reduce waiting time at the postal counters.

There are a number of counters which are considered unprofitable by PI. The CDP (specifically Art. 6, c.1) provides for the universal service obligation, imposed on peripheral post offices operating in remote areas which are unprofitable, to be derived based on their operating costs. For this purpose, direct and indirect costs will be taken into account and costs, the existence of which would rule out net revenues from counter activities, will be finally determined.

Average profitability can be gleaned from the following table:

Table C.18
Italy - Traffic Break-down in a Typical Unprofitable Counter

Type of counter	Units	Typical loss-making own counter
Average revenue from mark-ups and/or fees	Lit. 1,000s	15,000-25,000
Average costs of wages, rent, utilities, maintenance etc	Lit. 1,000s	90,000-115,000
Average loss per unprofitable counter (from above)	Lit. 1,000s	75,000-90,000
Number of unprofitable counters	Units	3,000
Average loss times number of unprofitable counters (from above)	Lit. millions	Ca. 290,000
Proportion of mark-ups and/or fees attributable to:		
a) sale of postage stamps, receipt of parcels, receipt of registered items and other <i>postal services business</i>	Per cent	20
b) Post Bank, Postal Giro and banking transactions, e.g. money transfers	Per cent	b) + c) = 75
c) social security payments, licences and other <i>government business you are obliged to carry out</i>	Per cent	*
d) other business <i>freely undertaken</i> , e.g. sale of greetings cards, stationery, currency exchange	Per cent	5
		100 per cent

* The social security payments proportion is zero because PI do not get paid for doing this.

Based on an analysis of the characteristics of customers at the post offices, it is possible to specify the proportion of revenue which is lost when a counter is closed. In the case of postal banking, lost revenue amounts to 15-25 per cent while in the case of postal service, this amounts to 2-8 per cent. These figures are not published, but arise from professional judgement by the members of the team within Poste Italiane who completed the questionnaire for this study.

This professional judgement concerning the volume of lost traffic relates only to postal and financial services of remote and unprofitable counters (which would simply result in customers reverting to more distant post offices and, hence, small revenue losses), not to the total postal traffic delivered on unprofitable routes. If postal delivery on unprofitable routes was no longer undertaken, this would have the consequence of much greater revenue losses as a number of customers would entirely abandon postal services. Informal estimates suggest that as much as 60-70 per cent of postal traffic would be lost.

Currently, PI deliver counter services on behalf of Treasury and other public administrations, the remuneration of which takes place on a conventional basis in the sense that Treasury is the sole share-holder of PI.

C.9.8 Costs and USO burdens

C.9.8.1. USO

The cost of the USO burden has been calculated for various groupings including:

- Sparse postal deliveries;
- Sparse parcel deliveries;
- Concessionary tariffs to particular institutions;
- Concessionary tariffs for particular types of mail; and
- Loss-making counters.

The methodology used to calculate the USO burdens for post offices was based on surveying revenues and costs, both direct and indirect. Art. 6, c.1 of the CDP states that the universal service obligation for peripheral post offices be derived based on their operating costs. For this purpose, direct and indirect costs will be taken into account. The estimated losses of small post offices in 1996 was established by EPI (and the Ministry) as Lit. 85 bn in total.

For periodical and newspaper subscriptions and electoral material, the method used is to calculate the difference between revenues that would be forthcoming under the ordinary tariff and those pertaining to concessionary rates. Art. 6 c.2 of the CDP states that the state undertakes to compensate PI for the difference between the tariff applied by law and the average annual tariff, based on the number of actual mailed items recorded by post offices.

Discussions between PI and the Treasury are continuing with respect to compensation payments for press items. PI had requested reimbursements of the order shown in the following table. After considerable delay, Treasury granted only Lit. 300 bn per annum, maintaining that the costs of PI are inefficient (see the report on USO costs for postal services in Italy in Appendix D).

For periodical and newspaper subscriptions, the Table C.19 was calculated by PI for the purpose of requesting reimbursement of these USO costs relating to the period 1995-1997:

Table C.19
Poste Italiane's Reimbursement Requests

Year:	Production	Direct Revenues from tariff: Lit	Indirect Revenues requested from the State: Lit
(Units are in millions)			
1995	1,689	270,000	680,000
Percentage change	-14.62	9.96	-39.41
1996	1,442	297,000	412,000
Percentage change	-5.62	21.54	17.72
1997	1,523	361,000	485,000

The USO for press items is calculated by PI based on the effective unit cost calculated by means of the activity based costing method. The figure for the resulting average cost is regarded as excessive, especially since, in practice, this category comprises three different products, each of which commands very different costs and prices. These include: press subscriptions, non-periodical press items and those related to mail-orders. Governmental compensation is forthcoming only for subscriptions. A more accurate estimate of this costs is discussed in the Report on USO burdens of Postal Services in Italy in Appendix D. PI uses a fully distributed cost basis for the estimates and has not considered the possible effects of an increase in prices on traffic volumes.

The Ministry regards the most costly USO as being delivery in rural areas, followed by delivery of newspapers and press articles; the delivery of parcels; and, finally, the maintenance of peripheral post offices.

C.9.8.2. Non-USO cost issues

In terms of the urban to rural split, 40 per cent of post is mailed within the city while the remainder is mailed in suburban or rural provinces. A survey has been undertaken which measured the direct delivery costs in urban and rural areas. The results showed that the costs of delivery account for 55.2 per cent of total costs (or 34.3 per cent net of manual sorting). Letters achieve positive margins for urban delivery. Negative margins were found for urban to suburban and urban to rural delivery paths. These survey results have been brought to the attention of the competition authority, in connexion with the POSTEL (hybrid mail) case. PI has recently been made to offer access prices for POSTEL delivery and, hence, has calculated the delivery costs for the eight delivery paths described in Appendix D.

PI does not currently have data on delivery costs and traffic volumes by individual delivery offices. A new survey system is currently being introduced to gather data on volumes of traffic per office and their relative costs, all within the context of management accounting.

C.9.8.3. Collection costs

Mail is collected from post boxes and post offices. Inward sorting is followed by transport and outward sorting before delivery takes place. The cost of collection is essentially invariant with respect to the volumes of traffic since the cost of the network is essentially a fixed cost.

In the event of varying mail volumes, the costs of transport will also vary depending on the type of transport effected. Rail transport costs are particularly rigid with respect to volumes while transport by bicycle or motor vehicle is more sensitive to volumes and transport by air is most volume-sensitive.

C.9.9 Financing

C.9.9.1. Services

Tariffs are revised on an annual basis. The criteria used to set tariffs are based on revenue maximisation taking into account the limits imposed by the reserved area and by services which are subject to discounted tariffs as detailed above (see Section C.9.4). By Article 5 of DPR 79/97, a maximum increase of ten per cent on tariffs for the reserved area is permitted.

Within the last five years, tariffs for parcels have been explicitly held down by the Ministry. In the context of the tariff proposals for 1995, the Ministry suspended the application for new tariffs relating to parcels which were lowered, as a consequence of this decision. Specifically, the tariff proposal by the postal administration involved raising the average tariff for parcels up to 3 kg from the 1995 average of Lit. 2,500 to Lit. 5,000 with effect from April 1995. This was rejected by the Ministry which allowed an increase to Lit. 3,500 with effect from July 1995.

Since 1997, the Ministry no longer regulates the prices of non-reserved services, with the sole exception of newspaper/press subscriptions (See Section C.9.4).

C.9.9.2. USO

The USO requires the postal administration to charge a uniform tariff for basic, standard letters, but a wide range of non-uniform tariffs currently exist in Italy because:

- Invoices (which in Italy, as described in the Report on USO Costs for Postal Services in Italy in Appendix D, are a separate product, outside the reserved area, and operate in a market characterised by dominance of the private agencies which have a market share of around 80 per cent of urban deliveries).
- As in the case of invoices, (which should really form part of the reserved area of letters but are, in fact, viewed as a category outside the reserved area), there are a number of letter types which are classified as press items (for example, VIACARD

credit card statements which relate to motorway payments) and these benefit from the reduced tariffs applicable to press items. This must also be considered part of the USO cost.

- The applicable tariffs for commercial communications such as non-periodical press items, sale catalogues for correspondence are based on a system of discounts relative to the quantity of items sent. Tariffs also distinguish items destined to urban locations and those destined to extra-urban locations.
- There are also written obligations to furnish discounted tariffs to the military.
- Written obligations also impose discounts for newspapers and magazines, other printed matter, braille items and all correspondence to and from both the President of the Republic and the Pope, as well as all items in connexion with political elections.

To pay for the USO, during the period 1994-96, PI received a fixed transfer from the State amounting to Lit. 1,200 billion, based on PI's request (see also Section C.9.8.1 and the Table C.20) for support of around Lit. 800 billion per annum over these three years. For 1997, the Financial Law recognises the burden imposed by the delivery network and by the USOs concerning the maintenance of offices with low traffic volumes but does not quantify this. A special fund has been set up for the compensation of concessionary tariffs which PI is made to offer on newspapers and other press items in subscription. In 1997, the size of this fund was Lit. 300 bn and in 1998, Lit. 400 bn have been allocated. All of these amounts for the financing of the USO are specified in Financial Laws 662/96 and 449/97.

Concerning the PI's request of ca. Lit. 800 bn per annum to cover the losses they made, this is made up of the following components for the year 1994:

Table C.20
Break-down of Poste Italiane's Request for Contribution to Losses

Items:	Percentage of Total
Peripheral Offices	15.3
Daily newspapers and periodical press	80.9
Concessions for electoral campaigns	3.8
Total	Lit 751,360,395,000

In practice, as a result of negotiations between EPI and the Treasury, the total amount of contributions has remained constant

In the absence of USOs, PI predicts that the main changes to its services would be the reorganisation of the network. In particular, this would mean altering the number of people assigned to both the delivery network and the uneconomic post offices as well as the closing-down of certain post offices. In terms of services, the absence of USOs might entail a revision of services and/or products offered, e.g. the abolition of telegrams and telexes.

Table C.21 provides a summary of how costs are split among activities.

Table C.21
Cost Proportions for Poste Italiane

	Letters (mail up to 2 kg)	Parcels (packages 2-10kg, or above 10kg if part of your USO)	Letters and parcels combined
Collection/clearance	17.7	3.6	14.4
Inward and Outward sorting	26.3	35.0	25.8
Trunking/transport	9.0	38.5	29.8
Delivery	47.0	22.9	30.0
Overhead costs (if any) which are not included in the above			
	100	100	100

C.9.10 Other Issues

C.9.10.1. Efficiency of operations

Concerning the efficiency of organisation of the enterprise, the Ministry believes that the major structural changes have already been undertaken when PI was transformed into the shareholding company EPI. The existing instruments of organisation should suffice to organise the company efficiently. The transformation into a shareholding company entailed changing all labour contracts into commercial ones. Also, proper auditing was introduced with the help of revised accounting principles and more information was forthcoming to conduct performance analyses.

C.9.10.2. EU Directive

In general, the Italian situation is such that while the reserved area is intended to be a *quid pro quo* for the USOs, in practice, EPI does not greatly benefit from the reserved area since parts of it are contracted out to private contractors (see Section C.9.10.3).

The Ministry believes that the main implication of the EU Directive for the Italian postal operations concerns the definition of the area of reserved activity. In particular, they anticipate that the current transfers from Treasury to cover the losses of EPI, incurred partly as a result of their current USO, will cease. Also, the concessions to private contractors on the reserved area will be revoked as a result of the EU Directive. However, the Ministry concedes that there may be legal problems in doing so.

There should also be a recognisable impact on the quality of service which, the Ministry argues, is outdated and does not reflect the exigencies of customers. In terms of the speed of delivery, the new target which is expected to be adopted is the delivery of 80 per cent of

priority letter items (à Lit. 1200) in J+1. There will also be two streams of letters each carrying a different tariff.

C.9.10.3. Agenzie di Ricapito (Delivery Agencies)

The Ministry has two main functions concerning regulation of the postal industry and the handling of concessions. In Italy, there is a legal clause (Art. 22 of the *Codice dell Poste (CP)*) which provides heads of district post offices the prerogative to contract out certain postal services, even of the reserved area, to so-called "agenzie di ricapito" (AdRs) or delivery agencies. This procedure is allowed only in times of "emergency", defined as times when the public service is not efficient enough in certain areas to carry out local deliveries, i.e. in peak periods. In these cases, authorisation is granted to private or other companies to deliver mail locally, within the reserved area.

The number of people living in the relevant postal district will determine the number of AdRs allowed to operate in the given area. For a population of half a million, one AdR is allowed, for one million, two AdRs are permitted and then for each additional million, another AdR can join the market.

The AdRs are taxed on each delivered item in order to perform this service. For each Lit. 800 letter they accept to deliver, they have to pay Lit. 300 to the post office for the right to carry out this reserved service. They keep the difference of Lit. 500 for each item.

In practice, these AdRs have established a *continual* presence in the delivery market. In particular, in performing these services, AdRs can market and sell their own delivery services, by striking deals with the biggest and most profitable customers (such as big public utilities) on their delivery rounds.

C.9.10.4. Low postal demand in Italy

Italy's postal market is characterised by low postal turnover, compared to other EU countries. For example, the average number of postal items handled per capita is 100 per annum, compared with a figure of 300 in Germany.

C.10. Luxembourg

C.10.1 Introduction

Table C.22
Luxembourg - Basic Statistics

	1992	1993	1994	1995	1996
Area of territory (square kms)	2586	2586	2586	2586	2586
Population (thousands)	390	400	400	410	420
Population density (people/km ²)	150.8	154.7	154.7	158.5	162.4
EPT employees (end year)	1690	1690	1696	1697	1698
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	5	5	5	5	5
Number of households without postal delivery	0	0	0	0	0
Number of delivery points (million)	n.a.	n.a.	n.a.	n.a.	0.178
Letter mail service (millions of items delivered)	117.6	124.5	123.6	120	121.4
Number of post offices	106	106	106	106	106
Revenue (LF million)	n.a.	n.a.	n.a.	n.a.	3209
Operating costs (LF million)	n.a.	n.a.	n.a.	n.a.	3454
Operating profit/(loss) (LF million)	n.a.	n.a.	n.a.	n.a.	-398

Source: Eurostats Demographic Statistics 1997; UPU Postal Statistics 1996; EPT questionnaire and subsequent responses

Notes: EPT employees include full-time and part-time workers. In 1996 there were, 1,232 full-time employees and 466 part-time. These figures include 68 full-time, and 15 part-time, workers in the giro department.

The postal administration in Luxembourg is called *Entreprise des Postes et Télécommunications* and was transformed into a public company on 10 August 1992. The postal sector is regulated by the Ministry of Communications.

C.10.2 Definition of the Universal Service Obligation

C.10.2.1. Primary and secondary legislation

The postal operator, *Entreprise des Postes et Télécommunications* (EPT), is bound by a minimum set of obligations specified in Articles 3 and 4 of the Law of 10 August 1992 which created the EPT. These are the provision of:

- Postal services;
- Financial postal services; and
- Telecommunications services.

However, there is presently no document which specifically defines EPT's USOs.

C.10.2.2. Memoranda, licences or agreements

EPT considers itself bound:

- To provide the following services throughout the country: letters, parcels, newspapers, *special services*¹⁴⁰, non-addressed direct mail, *EMS* courier services, and *Bureaufax*¹⁴¹;
- To give its consumers access to services at an affordable price;
- As the designated provider of the universal service under the forthcoming new law on postal services, EPT undertakes for every working day from Monday to Friday, with the exception of public holidays and of "material impossibility" (which has to be justified), to provide at least (i) one collection at the collection points and (ii) one delivery to each physical and legal person at an appropriate delivery installation.
- Under the present situation EPT understands the USO to comprise the collection, transport, sorting and distribution of postal items (other than parcels) and the acceptance, transport, sorting and distribution of parcels.
- In addition, there are a number of services which the government has determined EPT to deliver and for which EPT receives compensation in the form of a tax reduction. These services include (i) *Abonnements-poste* (daily and non-addressed printed material), (ii) *Procédé sommaire* (non-daily and non-addressed periodicals), (iii) *Quotidiens* (daily and addressed newspapers), (iv) *Périodiques* (non-daily and addressed periodicals) and, finally, (v) *Envois ATR* (printed material produced by non-profit organisations).

C.10.3 Reserved Services

Article 3 of Law of 10 August 1992 which created EPT gives the company the prerogative of a reserved area as specified in relevant legislation. This refers to the Law of 29 December 1990, specifically Article 1, which defines the postal monopoly as the transport of letters¹⁴² and post-cards. Exceptions of the postal monopoly are defined by Article 2 and relate to:

- Letters and postcards which are taken or collected from the neighbouring post office by household members or by special delivery¹⁴³;

¹⁴⁰ Special services include recorded deliveries, recorded electoral deliveries, registered deliveries, proof of receipt, delivery to the hands of the addressee, handling of fragile postal items, *poste restante*, and special collection or deliveries at habitation.

¹⁴¹ This service relates to items sent via a private fax machine which are transmitted either directly on to the addressee's fax or delivered by a postman.

¹⁴² Letters are defined as any written document or document which is not despatched in several identical copies and which is not the product of a mechanised or photographic process. Notes in place of letters which have been inserted into closed or open parcels are also counted as letters.

¹⁴³ It is prohibited that the special delivery serve more than one sender at a time.

- Bills accompanying shipped merchandise;

Letters and postcards sent or received by foreign military post offices which form part of NATO and are established on domestic territory, usually in war times.

C.10.4 Regulatory Responsibility

The Government has to approve prices for services for which EPT has been granted exclusive or special rights. During the last five years the Government has adopted a standstill for prices for postal services. Specifically, the most recent price rise was on 1st February, 1995. In order to receive compensation for the increase in charges (especially salaries), EPT proposed an increase in the basic tariff of around ten per cent with effect from 1st February 1998, proposals which have not been supported by the Government.

The Government also has to give its approval on matters concerning investment and profits payable to, and losses paid by, the Treasury.

The administrative council approves, on the basis of proposals made by the management board, the organisational structure of EPT, and this includes also the number and location of post offices. The Ministry could theoretically influence the decisions made by the administrative council concerning numbers of post offices by means of the Government representatives on the council.

The postal administration has responsibility for setting the standards of service.

Currently, a new law is being elaborated which will implement the EU Directive for postal services. This law will designate a national regulatory authority which will entail modification of these diverse competencies as described above.

C.10.5 Actual Service Provision

C.10.5.1. Delivery

Actual service provision for delivery is confined to one a day, before 2 pm, on Monday to Friday. On Saturday, there is one delivery of daily newspapers before midday.

The USO does not define a minimum target for the speed of delivering postal items. In practice, in 1996, 96.12 per cent of items were delivered in J+1 and in 1997, this figure increased to 97.1 per cent. Equally, the USO does not stipulate a minimum frequency of delivery to any area within the country.

There is a written obligation¹⁴⁴ on EPT to deliver to the domicile. This is limited to addressees who have installed letter boxes next to public ways, i.e. at the end of the drive. The written obligation also refers to post office boxes. As an exception to this rule, EPT also delivers mail to groups of letter boxes inside blocks of flats.

Currently, a total of 178,000 addresses are delivered to, of which 132,000 are delivered to a roadside box, 40,000 are delivered to groups of boxes in blocks of flats, and 6,000 go to post office boxes¹⁴⁵.

C.10.5.2. Collection

In rural sectors and small towns, collections are made as part of the delivery system. In bigger cities, mail tends to be collected as part of a designated network (of routes).

On weekdays (Monday to Friday), collections are made until around 5 or 6 pm, while some letter boxes are emptied up to 9 pm to guarantee a higher level of service provision. On Saturdays, collection takes place before midday.

C.10.5.3. Parcels up to 10 kg

The USO does not oblige EPT to deliver parcels up to 10 kg to the addressee's door. However, EPT's operational criteria determine that delivery is made to the addressee's door. Hence, 178,000 addresses receive parcels to their doors. As in the case of letters, there are no addresses which are not delivered to. The USO equally does not impose a minimum speed of delivery for parcels. EPT's target is 95 per cent in J+1, but actual performance in relation to this target is not monitored.

Parcels are distributed by postmen as part of the normal delivery rounds. In rural areas, parcels are collected as part of the delivery round or deposited at a neighbouring post office.

C.10.5.4. Counters

All 106 post office counters are owned by EPT. There are 42 distribution offices. While some counters are considered unprofitable, there is no data available.

C.10.6 Costs and USO burdens

C.10.6.1. EPT's views

In terms of ranking the cost implications of different USOs, EPT regards loss-making counters to be the most expensive, followed by the delivery of mail and parcels to rural

¹⁴⁴ *Conditions Générales Applicables aux Services Postaux*

¹⁴⁵ The total 178,000 can be broken down into addressed, non-addressed and newspaper categories.

areas; reduced tariffs for newspapers and magazines; reduced tariffs for ASBL items; and, finally, collection of mail and parcels in rural zones.

In the absence of USOs, EPT would tackle the problem of loss-making post office counters by reducing the opening times, exploring co-financing options with local communities and creating agency post offices. In addition, EPT would also charge full tariffs for services which are currently being furnished below cost.

C.10.6.2. USO burdens of concessions to press etc

Discounts are given to bulk users for pre-sorting their mail. In addition to this, certain groups of services receive discounts, which are fixed by a written obligation. These include

- Newspapers;
- Magazines and other publications; and
- Mail issued by non-profit organisations.

EPT receives compensation for these discounts in the form of a reduction in taxes to the Government (see also C.10.2.2).

Estimates of the costs of discounts relating to newspapers and mailing material issued by non-profit organisations (ASBL) have been made by EPT. These are summarised in the following table:

Table C.23
Cost Estimates of Delivering of Newspapers and ASBL Printed Material for EPT

Newspapers			ASBL materials		
(in LF mio)	1996	1997	(in LF mio)	1996	1997
Costs	406.7	424.9	Costs	85.0	85.6
Revenues	75.9	90.2	Revenues	39.7	45.6
Difference	330.8	334.7	Difference	45.3	40.0

In 1997, 540 employees are involved in delivery of which 420 are postmen and 120 are (part-time) newspaper deliverers. The average hourly cost of delivery staff (including pensions and social security contributions) in Luxembourg is LF 1,095 for postmen and LF 655 for newspaper deliverers. The reason for this difference is the status of postmen as state employees with all the resulting benefits. By contrast, newspaper deliverers are hired on a more temporary basis. In 1997, postmen made 171,500,000 deliveries. These can be broken down as shown in Table C.24 following:

Table C.24
Luxembourg - Breakdown of Deliveries, 1997

Deliveries to:	171,475 letter boxes	6,525 post office boxes
Addressed items:	103,300,000	18,200,000
Newspapers:	20,500,000	1,000,000
Non-addressed items:	27,500,000	1,000,000
TOTAL:	151,300,000	20,200,000

Newspaper deliverers delivered 15,500,000 newspapers to 45,000 letter boxes throughout 1997.

C.10.6.3. USO burdens: universal service

EPT could not provide a split of total costs into different processing activities such as collection, sorting, transport and delivery costs. However, EPT felt that the estimates quoted in the European Commission's Green Paper of 1992 did not reflect their cost apportioning accurately. In particular, it was felt that 65 per cent as a figure representing distribution costs as a percentage of total costs was too low.¹⁴⁶ During the Reims negotiations involving termination charges, distribution costs were felt to be closer to 80 per cent.

EPT were also not able to provide any figures on differences in delivery costs per item in Luxembourg, nor on the proportions of delivery that are to urban and rural addresses. Consequently we are not able to provide an estimate of the USO burden of universal delivery, in Luxembourg in this study. However, given the relatively small geographical area and the fact that much delivery is to roadside boxes, which might be expected to reduce the costs of rural delivery, we would not expect these burdens to be high in relation to turnover, compared to the situation in other Member States.

¹⁴⁶ All other countries' administrations which expressed a view on this matter, or who provided data, thought that 65 per cent for delivery was too high.

C.11. Netherlands

C.11.1 Introduction

Table C.25
Netherlands - Basic Statistics

	1993	1994	1995	1996	1997
Area of territory (square kms)	40844	40844	40844	40844	n.a.
Population (thousands)	15,290	15,380	15,450	15,520	n.a.
Population density (people/km ²)	374.4	376.6	378.3	380.0	n.a.
PTT Post employees (full-time equivalents for business unit mail)	36,851	35,901	35,188	34,847	36,539
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	6	6	6	6	6
Number of households without postal delivery	0	0	0	0	0
Average delivery points in NL (in thousands)	6,703	6,800	6,900	7,001	7,096
Total mail delivered (millions of items delivered, domestic and international receipts)	5,982	6,108	6,240	6,415	6,629
Number of post offices	2,210	2,388	2,352	2,628	2,591
Revenue (guilders million)	5,617	5,727	6,080	6,710	15,267
Operating costs (guilders million)	5,166	5,149	5,359	5,767	13,943
Operating profit (guilders million)	363	443	541	636	694

Source: Eurostats Demographic Statistics 1997, UPU Postal Statistics 1996, Facts & Figures 1997 TNT Post Group. Notes: 1997 revenue and cost figures include TNT, operating income after tax.

The Netherlands is in some sense a special case because the postal administration was already corporatised on 1 January 1989. At that time, PTT Post became part of the KPN Holding, to which PTT Telecom also belongs. A new change has taken place at the end of June 1998. The KPN holding has de-merged into a separate post company, called TNT Post Group (TPG) and a separate telecommunications company KPN Telecom. TPG has been floated on the Amsterdam, New York, London and Frankfurt stock exchanges.

C.11.2 Definition of Universal Service Obligation

The Postal Act (Postwet), Art 2.2 defines the obligations of the concession holder: "The concession holder is obliged to transport for every person in the whole country for a payment letters and other addressed items".

A complementary decree on postal sendings (Besluit Postzendingen), Art 1 specifies this. The obligation holds for national postal items up to 10kg¹⁴⁷.

Another complementary decree "General Postal Guidelines" (Besluit Algemene Richtlijnen Post), defines the quality requirements associated with the USOs. The postal concession holder is obliged to:

- provide a differentiated supply of services;
- deliver post one day after it is posted;
- maintain a minimum network of mailboxes;
- maintain a minimum network of counters;
- charge uniform tariffs for the identical services in the whole country;
- change tariffs within the limits set by a price cap;
- supply information regarding these quality requirements to the Minister and the postal regulator.

The General Postal Guidelines do not distinguish between letters and parcels. The USOs hold for both categories.

According to UPU rules, as well as in Dutch law,¹⁴⁸ TPG has an obligation to provide postal services to the blind free of charge. There is also an unwritten obligation that newspapers and periodicals are charged at lower tariffs.¹⁴⁹ Following a legal procedure on this, however, there has been an agreement between TPG and the main publishers in the Netherlands that tariffs for newspapers and periodicals will gradually move towards a normal tariff level.

C.11.3 Reserved Services

The reserved areas for the postal concession holder in the Netherlands are defined in the Postal Act, Art 2. There it is said that the concession holder has the exclusive right:

- to transport letters up to 500 gr;¹⁵⁰
- to place mail boxes along public ways;

¹⁴⁷ This decree also sets size limits: USO hold for items up to a maximum dimension of 100 cm and the next largest dimension of 50cm.

¹⁴⁸ General Postal Guidelines, Art. 12.2 f.

¹⁴⁹ This is implicitly formulated in the General Postal Guidelines, Art. 6.1.

¹⁵⁰ The new Postal Act which will go to Parliament at the end of 1998 specifies letters up to 100 gr and the tariff area below three times the tariff for the lowest weigh letter as the reserved area.

- to print stamps with a picture of the King and/or the word 'Nederland' on it.

In Art 12, the Postal Act defines exceptions for which the reserved areas are not exclusive to the concession holder. The main exception is courier services (for letters up to 500 gr). A special decree on minimum tariffs for courier services ("Besluit minimumtarieven koeriersdiensten") specifies this in more detail and states that the minimum tariffs that others than the concession holder have to charge are Fl 11.90 for courier services within the EU and Fl 17.50 for carrier services outside the EU.

C.11.4 Actual Service Provision

There is an obligation for TPG to deliver postal items (up to 10 kg) every working day. This implies that there must be deliveries 6 days a week, including Saturdays. TPG indicated that the actual level of delivery is 6 days a week, including Saturdays. In case it has not been possible to deliver to an address, for example, because the addressee was not at home, for parcels there is a second delivery. There is a separate system for parcel delivery.

The General Postal Guidelines state that postal items need to be delivered one day after posting. This indirectly defines an obligation for collection. Collection takes place every working day, and also on Sundays. TPG indicated actual frequency of collection is according this obligation.

Table C.26 below shows the actual performance regarding speed of delivery for 1993 to 1997. Most private and business letters need to be delivered next day. The table gives the percentages that were actually delivered next day. There is a special service for large customers: mail is delivered less speedily (within 48 hours instead of 24 hours) at lower charges.

Table C.26
TPG's Quality Performance

	1997	1996	1995	1994	1993
Private letters: 24 hour	95%	95%	95%	95%	93%
Business mail: 24 hour	96%	95%	96%	95%	94%
Business mail: 48 hour	97%	96%	97%	97%	97%
Parcels: 24 hour	96%	97%	97%	95%	97%

Concession report 1997.

Starting from the situation in 1989, the General Postal Guidelines (par 2) state that in communities with more than 5000 residentials, there needs to be at least one counter within a radius of 5 km. Above that for every extra 50,000 residentials, there needs to be at least one extra counter. Outside communities (in rural areas) the concession holder needs to provide a comparable service. TPG used to have mobile counters in these cases. Now they have so-called 'A-minis, which are counters that provide less services.

'Postkantoren BV', the network of counters, is a joint venture of Postbank (part of ING group) and TPG (PTT Post). Counters provide financial services for the Postbank and post-related services, like stamps, parcels, telegrams, express, for TPG. Increasingly, counters also offer services for other parties (for example, KPN telecom, tax agency, car rentals, post-related articles, job agencies, and so on). The number of shops of Postkantoren BV in 1996 was 2,679. This includes own post offices, franchise, postal agencies but also a chain of book shops ('Bruna' and 'Boekeliers' shops), that was bought in the beginning of 1996. In the future, this books chain will also provide postal services and products. TPG makes increasingly use of agencies. Table C.27 gives an overview of the counter network of TPG.

Table C.27
TPG's Counter Network

	1996	1995
Own counters	758	798
Franchise counters	128	111
Postal agencies	1,024	1,100
Postal agencies with limited assortment	419	343
Bruna- and Boekeliershops	350	-
Total	2,679	2,352

Annual report 1996 Postkantoren BV.

C.11.5 Regulatory Responsibility

In the Netherlands, the Ministry of Transport, Public Works and Water Management (more precisely, the Directorate General for Telecommunications and Post ("Hoofddirectie Telecommunicatie en Post")) is responsible for drafting laws related to the postal sector and for developing postal policy.

On 1 August 1997, an independent regulator for post and telecommunications was established. This regulator is called OPTA (Onafhankelijke Post en Telecommunicatie Autoriteit: Independent Post and Telecommunications Authority). OPTA's task is to carry out and execute the Dutch postal laws. Regarding post, OPTA's main task is to control the exclusive concession and USOs as described in the Postal Act, Art 2.1 and 2.2.

Since 1 January 1998, another Dutch regulating body has been active, the Dutch competition authority ("Nma", Nederlandse Mededingsautoriteit). In the postal sector, the role of the NMa is limited to competition matters, ie looking after abuse of the dominant position of TPG. The NMa, for example, in this light could check the tariffs for services outside the reserved area (outside the price cap system that is employed for most of the universal services). PO Boxes are an example of such a service.

The final responsibility for investments, return on capital, profits and losses is completely with TPG¹⁵¹. As far as prices, standards of service and number of post counters are concerned, besides TGP, there are responsibilities for the Ministry and OPTA.

Regarding prices, the Ministry has designed a price cap system which is explained in the General Postal Guidelines. The price cap is basically the labour cost index. There are two baskets of mandatory services: one basket with all services and one with services which are typically used by small users. OPTA checks each time tariffs change whether the tariff changes that TPG proposes for mandatory services are within the limits set by this price cap. Table C.28 shows the price cap and the development of the tariffs for the basket services. The table shows that price increases have remained below the limits set by the price cap. TPG has indicated that in practice tariffs for business customers are usually revised every year (on 1 January). The tariffs for private customers are usually revised once in every couple of years (and then in steps of 5 cts). The current price for a letter or postcard is 80 cts.

Table C.28
TPG's Development of Wage Costs Index and Tariffs

	1997	1996	1995	1994	1993
Index of wage costs (price cap)	121.3	116.8	114.2	112.1	109.5
Mandatory services					
Total tariff index	109.1	105.5	104.8	103.3	100.0
Small user's tariff index	110.2	106.2	105.9	104.3	100.0

Source: *Prospectus TNT Post Group, 26 May 1998*

Another important area related to tariffs is the possibility of giving discounts. The General Postal Guidelines permit discounts to large customers. TPG is allowed to differentiate prices but not to discriminate (identical customers should have identical discounts). No geographical discounts are allowed. TPG has indicated that discounts for large customers are set on a case-to-case basis. In order to get bulk-mail discounts, a customer has got to have at least 50 items. Besides bulk-mail discounts, there are also large-user discounts. These discounts are not published by TPG but OPTA has the right to see the contracts.

TPG is not allowed to cross-subsidise non-exclusive and non-USO areas by revenues from exclusive service and USO areas. There is an obligation for TPG to keep separate accounts in this respect. The Ministry has indicated that new legislation is needed to deal with cross-subsidies between reserved and non-reserved areas.

Regarding standards of service, the Ministry has defined in the law general standard requirements. For a limited number of services, OPTA controls the quality level. Quality standards of other services are up to the discretion of TPG. The same holds for post office

¹⁵¹ Profits are partly payable to the Ministry of Finance because the Ministry has a 40% share in PTT Post. There are no further obligations on top of that.

counters. The Ministry has set a general standard in the General Postal Guidelines. OPTA checks each year whether this standard is met.

C.11.6 Costs and USO burdens

TPG was not prepared to provide any cost data for this study, other than those which are in the public domain. However, during our interview with them TPG indicated that (delivery) costs are rather uniform over routes. There are almost no unprofitable routes in the Netherlands, apart from a few exceptions, in the current situation, given current cost and price levels.

TPG commented on the methodology of measuring USO burdens. TPG stated that currently, on the basis of the NERA methodology, **currently** they had no USO burdens. However, this did not imply that TPG did not need reserved areas. It could well be that there will be USO burdens if reserved areas are cancelled. This could be due to volume decreases which make unit costs increase. Another point related to this that was brought forward by TPG was that although there are no USO burdens, TPG could operate more efficiently without USOs.

Residential customers only account for five per cent of PTT Post's turnover. Therefore the USO costs related to residential customers are fairly limited. Business to business mail and business to residential mail account for 95 per cent of total volume. Economies of scale in delivery are mainly achieved through this business mail. If PTT Post maintained the business mail level, then due to economies of scale costs would remain almost unchanged.

TPG made the point that competitors would need to provide universal service in order to enter the market successfully (just from a commercial point of view). However, since they face no USOs, they would have no need for delivery each day (they would, say, deliver once a week). Another point is that new entrants can use part of TPG's network, for example, for remote areas. To illustrate this, MediaNet (which provides postal services in the periodical market) is a competitor and a client of TPG at the same time. MediaNet gets normal, non-discriminatory discounts.

In the absence of USOs, TPG would:

- Probably lower the frequency of delivery; TPG would, for example, not deliver on Mondays because there tend to be low volumes on Mondays (business mail is delivered on Saturday so there is only private mail on Monday);
- Change its counter network. Currently a loss is made each time a person buys a single stamp at a post office. It would be better to sell stamps, for example, in supermarkets.
- Price differentiation would be applied, depending on competition.

TPG did indicate that the burden of the free braille postal services was around 20 ml guilders, that is compared with the case in which the blind would pay normal tariffs.

C.12. Portugal

C.12.1 Introduction

Table C.29
Portugal - Basic Statistics

	1990	1991	1992	1993	1994	1995	1996
Area of territory (square kms)	91906.3	91906.3	91906.3	91906.3	91906.3	91906.3	91906.3
Population (thousands)	9919.7	9872.9	9860.3	9864.6	9892.2	9912.1	9920.8
Population density (people/km ²)	107.9	107.4	107.3	107.3	107.6	107.9	107.9
Correios employees (average no.)	17042	17402	16743	16305	16008	15954	16041
Average number of deliveries per week in all areas	5	5	5	5	5	5	5
Average number of deliveries per week in rural areas	4.7	4.7	5	5	5	5	5
Number of households without postal delivery	0	0	0	0	0	0	0
Number of delivery points (million)	4.30	4.31	4.32	4.33	4.34	4.35	4.36
Postal traffic (millions of items)	678	761	825	889	1018	1105	1210
Company post offices	1113	1106	1077	1058	1056	1055	1059
Revenue (million escudos)	42389	55025	61282	72616	74613	80447	88577
Operating costs (million escudos)	47294	59541	64675	74410	74552	76022	81641
Operating profit/(loss) (million escudos)	-4905	-4516	-3393	-1794	61	4425	6936

Source: Eurostats Demographic Statistics 1997, CTT Correios Annual Reports, 1995, 1996, Information from CTT.

C.12.2 Main features of the current environment

Postal services in Portugal are provided by *CTT Correios*, which is a state-owned company, although it has the same legal status as a private company¹⁵². The *Instituto das Comunicações de Portugal (ICP)* is the regulatory body and performs its functions under the tutelage of the *Secretaria de Estado de Habitação e Comunicações*¹⁵³, which in turn depends upon the *Ministério de Equipamento, do Planeamento e da Administração do Território*¹⁵⁴.

¹⁵² Decree-Law 87/92.

¹⁵³ Secretary of State of Housing and Communications.

¹⁵⁴ Minister of Equipment, Planning and Territorial Administration.

The Regulation for the Public Postal Service¹⁵⁵ establishes that the public postal service consists of:

- the acceptance, transport, distribution and delivery of all sealed mail, postcards and other messages, even if open, whenever their content is personal and current;
- the issue and sale of stamps and other postal values; and
- the public telefax service.

Apart from the above services, other activities can be provided through the public post office network, namely:

- The acceptance, transport, distribution and delivery of parcels; and
- financial postal services¹⁵⁶.

In practice, the services provided by *CTT Correios* can be grouped into two broad categories: postal services and financial services. The postal business accounted for 90 per cent of CTT revenue in 1996, whilst revenues from financial services equalled 8.8 per cent of total operating income.

In regard to postal services, *CTT Correios* divides its mail business into three businesses¹⁵⁷:

- *Letter mail*, which consists of non-priority mail/ordinary mail, priority mail/"blue" mail and advertising mail (direct mail and unaddressed items). Letter mail makes up the bulk of the *CTT Correios* business, and in 1996 contributed about 73 per cent of the total operating income. Of the total of addressed items handled in 1996, 79.4 per cent was ordinary mail, 3.2 per cent was registered mail, 13.8 per cent was direct mail and 3.6 per cent was blue mail.
- *Parcels*, which contributed 7.7 per cent of total operating income in 1996. In 1996, about 12 million parcels were transported.
- *EMS - Urgent mail*, which accounted for 4 per cent of total operating income in 1996.

In 1996, *CTT Correios* employed 16,041 staff. Revenue equalled 88,577 million escudos, and operating costs were 81,641 million escudos, which implies an operating profit of 6,936 million escudos. As a limited corporation, although with all shares owned by the state, the postal operator CTT does not receive any subsidy from the state.

¹⁵⁵ Decree-Law 176/88.

¹⁵⁶ As examples of financial services provided by *CTT Correios* we would include, money orders, some sort of saving bonds and the postal collection of invoices and taxes. Additionally, it is currently under discussion the creation of a Postal Bank, although nothing has been decided yet.

¹⁵⁷ The reserved services are national and international traffic of letters and postcards and direct mail.

C.12.3 Independent regulatory body

In 1989 the *Instituto das Comunicações de Portugal* was created as a public institute endowed as a legal entity, and with administrative and financial autonomy. According to ICP officials interviewed, this body is an independent regulator.

ICP has both own competencies (in particular concerning the regulation of the market and standardisation) and advisory functions as well as the co-ordination of the State representation in international bodies of both the telecommunications and the postal sector.

C.12.4 Prices

Under the current regulation in Portugal, prices for reserved services are agreed between *CTT Correios*, ICP and the *Direcção Geral do Comércio e da Concorrência*¹⁵⁸ (*DGCeC*) in the annual Price and Quality of Service Convention. Prices for liberalised services can be freely set by *CTT Correios*.

The general principles taken into account in the price revision are cost orientation, transparency and non-discrimination. Additionally compliance with quality of service criteria affects the tariff changes which *CTT Correios* is allowed to make¹⁵⁹. "Affordability" is implicit in the price revision, in so far as it takes into account increases in the consumer price index.

Tariff levels were not explicitly frozen in 1994, but the fact that the annual convention on prices was not held in the beginning of the year meant that prices remained unchanged until a new convention was signed in the end of the year. According to *CTT Correios'* estimates, this implied a reduction in revenues of 2,500 million escudos. Prices have decreased by seven per cent in real terms over the last eight years, which *Correios* estimates to have led to a reduction in revenues of 8,000 million escudos.

With the exception of parcels, where a distance-dependent tariff exists¹⁶⁰, *CTT Correios* charge a uniform tariff for their mail services.

C.12.5 Investment

Since *CTT Correios* has the same legal status as a private company it is free to decide the amount of money allotted to investment and to allocate these funds across the organisation.

¹⁵⁸ General Directorate of Competition and Trade (the competition authority).

¹⁵⁹ ICP uses a method which calculates the deduction associated to failure to comply with the minimum targets for each Indicator of Quality of Service. The maximum reduction in tariff is 1%.

¹⁶⁰ There is a zonal pricing system which has three tariffs and a different one for Azores and Madeira.

C.12.6 Return on capital

The existing regulation does not define any requirement on return on capital.

C.12.7 Standards of Service

Quality levels for letter mail are, as prices, agreed between *CTT Correios*, ICP and the DGCEC, in the annual Price and Quality of Service Convention. The following table shows the 1998 targets for delivery times¹⁶¹.

Table C.30
Targets for Delivery Time by CTT Correios, 1998

Description	Minimum target	Objective target	Relative importance
Delivery time for ordinary mail (D+3)	95%	95.7%	40%
Ordinary mail not delivered within 15 working days (D+15)	3 per 1000	2 per 1000	7.5%
Delivery time for priority mail (D+1)	95%	96.2%	35%
Priority mail not delivered within 10 working days (D+10)	3 per 1000	2 per 1000	7.5%
Queuing time at post offices (minutes) - average	5	4	5%
Queuing time at post offices (minutes) - busiest hour	8	5	5%

Source: ICP

As mentioned previously, failure to comply with any of the targets set for the quality of service, affects the price variations permitted in the next Convention.

C.12.8 Numbers of post offices

In principle, *CTT Correios* is free to close post offices¹⁶² or reduce their opening times but taking into account the actual needs of the population. However, in practice it is almost impossible to close offices because of public opposition.

In 1996 *CTT Correios'* counter network consisted of 1,059 post offices owned by CTT, plus 2,587 postal agencies, and around 5,000 stamp sale points. The delivery network was made

¹⁶¹ Note that there is an additional indicator of quality of service related to queuing time at post offices (last two rows).

¹⁶² Article 3.2 of the Decree Law 176/88.

up of 430 postal delivery centres, with 6,076 individual postal delivery routes. About 5 million postal items were delivered daily.

C.12.9 Universal Service Obligations in Portugal

The core of the relevant legislation covering postal services is:

- The Decree-Law 283/89 of 23/08;
- Decree-Law 176/88 of 14th May 1988: *Regulamento do Serviço Público de Correios*.¹⁶³
- Decree-Law 207/92 on 2nd October 1992: *Regime de Fixação de Preços do sector das comunicações*.

In accordance with the EU Directive for Postal Services, within the coming months a new law will be passed in Parliament, which incorporates several changes with respect to the current wording, including a definition of the USO and a new concept of reserved services. Subsequently it will be approved by a Concession Contract, which will set up the precise conditions of the universal service rendered by the public postal operator.

The current legislation does not cover the definition of universal service, although the Regulation for Public Postal Service defines a similar concept: public postal services. Additionally, as noted in Section C.12.7 above, the Price and Quality of Service Convention implicitly recognises concepts linked to the Universal Service Obligation such as the principle of affordability by linking tariff changes to the consumer price index or to quality indicators such as queuing time.

C.12.10 Reserved Services in Portugal

The reserved services in Portugal include¹⁶⁴:

- the acceptance, transport, distribution and delivery of all sealed mail, postcards and other messages, even if open, whenever their content is personal and current¹⁶⁵;
- the issue and sale of stamps and other postal values; and
- the public telefax service.

The reserved sector referred to above does not cover:

¹⁶³ Regulation of the Public Postal Service.

¹⁶⁴ Article 3 of the Regulation of the Public Postal Service.

¹⁶⁵ This definition is valid for urban, national and international service.

- The private mail transportation as a non-lucrative activity or subsidiary to another main activity, provided that this transportation is carried out by the sender himself within the confines of the location where he has his headquarters, agency or branch.
- The mail transportation between several establishments, agencies or delegations of the same freight company provided that this is carried out by the company itself and that the mail is exclusively related with matters of their own service.

This definition of reserved services implies that domestic and international traffic of letters and postcards and direct mail are reserved. On the other hand, there is direct competition for parcels, newspapers, periodicals and unaddressed items.

C.12.11 Delivery obligations

Current legislation does not specify a minimum frequency of delivery for post items. However the public postal operator traditionally provides one daily door-to-door distribution for post items up to 2Kg, every working day (Monday to Friday) in any area (either densely or sparsely populated) and for any type of addressee (either business or residential). Exceptionally, there could be more than one delivery per working day or on Saturday and Sundays. These exceptions are agreed with specific clients, who are usually large customers.

Article 21 of the Regulation for the Public Postal Service establishes that mail shall be distributed at the address indicated by the sender or at the postal establishment of the final destination, depending on whether door-to-door delivery of post is in operation in the said area.

This wording implies that there are addresses which do not receive mail at their premises. *CTT Correios'* estimates that 4.2 million addresses receive delivery to the door. In addition there are 60,000 addresses which receive mail in grouped post boxes, and 20,000 in post offices or rural agencies. The latter occur in areas where access difficulties and geographic dispersion make postal delivery difficult, and residences with temporary occupation. These problems occur mainly in the northern and inland parts of Portugal, and in parts of the Azores and Madeira. There are also 80,000 points of delivery in the post offices (post office boxes).

Post items weighting more than 2Kg, are delivered at the addressee's door by prior agreement, and on payment of an additional charge. If this is not done parcels must be reclaimed at the post office closest to the addressee's premises. According to *CTT Correios'* figures, parcels could be delivered to 4.2 million addressees' doors whilst there are 160,000 addresses which actually receive this service.

C.12.12 Other USO obligations

Current legislation does not specify a minimum frequency for collections, although there is at least one collection per working day for mail up to 2Kg.

As stated above, the levels of quality of service are set annually during the Price and Quality of Service Convention. *CTT Correios'* performance during 1997 was 96.7 per cent in D+1 (priority mail) and 95.9 per cent in D+3 (non-priority mail). The counters network also has targets in terms of queuing time at post offices. In the case of parcels, the operator's performance in 1997 was 94.5 per cent in D+3, but this is an internal target and is not subject to regulation. It should also be noted that CTT's performance has always satisfied the Convention's targets.

Additionally *CTT Correios* has a written obligation to provide lower tariffs for the following types of mail traffic/users:

- *Newspapers and periodicals.* The Decree-Law 37-A/97 and Law 21/97 establishes that the State subsidises the postage of periodicals destined to people in Portugal or abroad. This subsidy is applicable exclusively on the cost corresponding up to 200 gr. per item¹⁶⁶.
- *Populations with special needs.* Law 21/97 states that the State subsidises, under certain conditions, 100 per cent of the post paid payment of periodicals specialised in matters related to handicapped people. The internal norm 44/89 of CTT envisages that correspondence in braille is subject to payment only in the cases when special services are used. This norm also reads that, with respect to *braille items*, tariffs applicable to special services destined abroad correspond to the special tariffs of the national service.

C.12.13 Estimating the cost of USO burdens of postal services in Portugal

Up to now, *CTT Correios* have estimated the burden of the USO in the case of concessionary tariffs to particular institutions¹⁶⁷ although we have not yet seen any results of this analysis. *CTT Correios* also have total cost and revenue estimates for several lines of products (letters/parcels/courier services). These estimates calculate costs and revenues for each of these categories on a fully-allocated cost basis. In general terms costs in the northern part of the country, inland and island territories are higher than in other locations, although they have not yet been quantified by CTT.

¹⁶⁶ Tariffs were set in an agreement signed in 1995 between *CTT Correios* and the Press Association.

¹⁶⁷ The methodology used by *CTT Correios* is fully distributed costs.

Additionally in the opinion of the postal operator, the current USO obligation affects *CTT Correios'* performance. If it did not have these obligations *CTT Correios* would continue to provide services under the following circumstances:

- A market-orientated price strategy;
- Prices related to costs, with differences based on distance and traffic; and
- Constraints on the geographical coverage for the provision of services.

The postal network would also be affected in the case of the non-existence of USO:

- Design of the network depending on market forces;
- Not daily deliveries/collection in zones of weak traffic; and
- Reduction in the number of post offices in the inland part of the country.

ICP has not carried out any estimation of the burdens of the USO. However they believe that the most costly activities are (in descending order of importance): registered mail; postal parcel service; editorial mail (newspapers/periodicals) and ordinary mail. For their part, *Correios* believe that the most costly activities are: the maintenance of the universal network of post offices; the mandatory distribution of products/services with subsidised tariffs (newspapers, books, periodicals); the existence of a uniform tariff across the national territory; a non-adequate tariff structure and sparse postal deliveries.

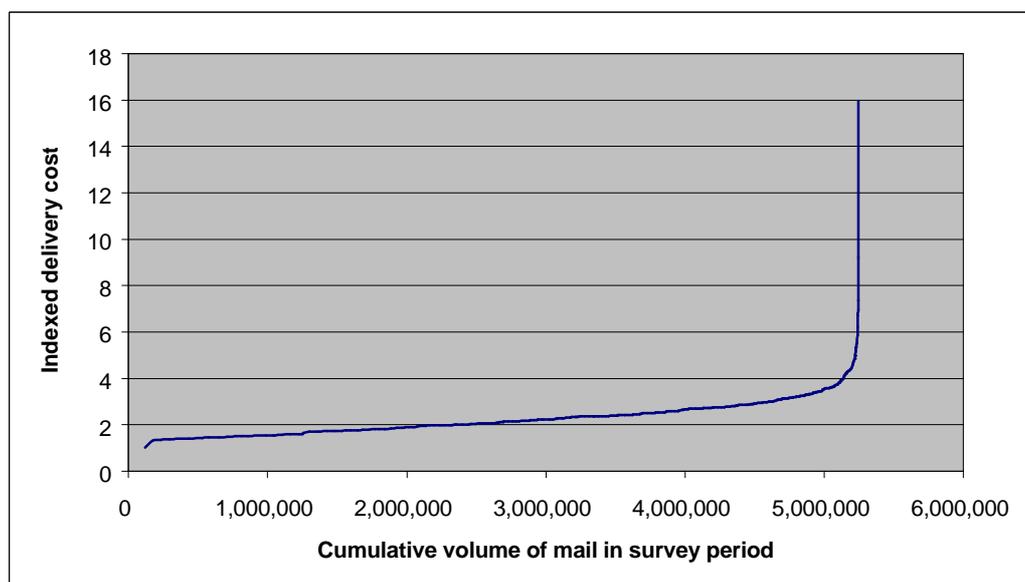
Correios supplied the present study with some confidential data on the split of costs between different functions for letter mail and parcels combined which we have used in our estimates.

Correios also supplied data on the 430 individual delivery offices in Portugal. These data consisted of information on:

- Number of postmen, Centre Chiefs, and Centre sub-chiefs employed in each area; and
- Numbers of items of addressed mail for delivery in each area.

From these two series we calculated a delivery cost index in the form of "equivalent number of postmen required to deliver one letter". This is shown in Figure C.8:

Figure C.8
Delivery Cost Index for Portugal



In calculating USO costs we looked at the avoidability of costs other than delivery using cost elasticities for the different activities performed by *CTT Correios*. Since we did not have direct evidence from Portugal, we based these on econometric estimates for other countries, and used values of 0.4 for outward sorting (which includes collection in Portugal), and 0.3 for transport.¹⁶⁸ These values imply that if traffic is withdrawn from the network, a ten per cent fall in traffic would in the long run lead to a four per cent fall in collection/sorting costs and a three per cent fall in transport costs.

Under these assumptions, our model estimated the burden of the USO for mail in Portugal, on a fully distributed cost basis, as 3,687 million Escudos in 1996, and, on an avoidable cost basis, as 393 million Escudos. This latter figure represents the amount over the price of the services that would be saved if the "unprofitable" part of the service were withdrawn.

Our estimate of 3,687 million Escudos for the USO burden on a fully allocated basis represents 4.8 per cent of CTT Correios' mail turnover in 1996, while our estimate of 393 million Escudos, for the USO burden on a net avoidable cost basis, represents 0.5 per cent of mail turnover in 1996.

These estimates are based on a unit revenue figure of 60.97 Escudos, and a unit cost figure of 56.50 Escudos. The latter figure excludes extraordinary costs associated with contributions to CTT's pension fund, and capital costs.

¹⁶⁸ We assume no changes in unallocated costs when traffics change.

CTT Correios estimate that the burden due to concessions for press material amounted to 2,318 million Escudos in 1997.

C.13. Spain

C.13.1 Introduction

Table C.31
Spain - Basic Statistics

	1991	1992	1993	1994	1995	1996
Area of territory	505990	505990	505990	505990	505990	505990
Population (thousands)	38874.6	38965.2	39050.6	39121.4	39177.4	39241.9
Population density (people/km ²)	76.8	77.0	77.2	77.3	77.4	77.6
Correos employees (annual average)		66722	65579	65355	65140	64897
Average number of deliveries per day in urban areas	1	1	1	1	1	1
Average number of deliveries per week in rural areas	5	5	5	5	5	5
Number of households without postal delivery	0	0	0	0	0	0
Mail service (millions of items)	4203	4362.9	4189.8	4220.1	4316	4414.7
Number of post offices	11898	11828	11693	11350	11083	10917
Number of post offices in urban areas	1618	1660	1686	1704	1732	1747
Number of post offices in rural areas	10280	10168	10007	9646	9351	9170
Revenue (million pesetas)	104560	129219	130575	140115	147586	153254
Costs (million pesetas)	155189	174434	173771	171520	179887	189518
Loss (million pesetas)	-50629	-45215	-43196	-31405	-32301	-36264

Source: *Correos Annual Reports 1992 and 1996; Ministerio de Fomento Anuario Estadístico 1996; UPU Postal Services*

Postal services in Spain are provided by *Correos y Telégrafos*, which is set up as a *Entidad Pública Empresarial*¹⁶⁹, a sort of state-owned firm. It has its own legal status and assets, and full capacity to act. The sponsoring government ministry is *Ministerio de Fomento* (Ministry of Public Works) through the *Secretaría General de Comunicaciones* (the General Secretary of Communications).

In 1996, *Correos y Telégrafos* employed 64,896 staff (of which 70.5 per cent were civil servants) and maintained a network of 11,100 post offices of which more than 9,000 were located in rural areas.¹⁷⁰

The main functions of *Correos y Telégrafos* are:

- management and operation of basic postal and telegraphic services;
- management and operation of the rest of postal and communication services;

¹⁶⁹ Royal Decree 176/1998.

¹⁷⁰ Source: *Correos y Telégrafos' Annual report, 1996.*

- provision of money order services;
- issuing of stamps, collaborating with the Ministry of Economy and Finance;
- provision of those telecommunication services envisaged by the current legislation.

In practice, the services provided by *Correos* can be grouped into three different categories: postal services, telegraphic services and money orders. The postal business accounted for 91 per cent of revenue, telegraph business for 4.4 per cent, money orders for 2.2 per cent and Nexus (an agreement between *Correos* and the bank Argentaria by which the bank uses *Correos*' offices network to sell financial products) for 0.7 per cent. The remaining 1.05 per cent belongs to financial and other revenues¹⁷¹.

With respect to postal services, *Correos* divides its mail business into three main parts:

- *Básicos*, which are letters and postcards;
- *Económicos* (printed matters and parcels); and
- *Urgente* which is the priority mail business (letters, postcards and parcels -Postal Exprés).

In 1996 these accounted for, respectively, 69, 30 and one percent of the mail items handled. There is a single combined delivery network for letters and parcels, while the counters primarily provide postal rather than financial services. There are no separate cost accounts for different parts of the business.

Correos is not financially self-sufficient. In 1996 revenue equalled 153,254 million pesetas, and costs were 189,528 million pesetas, resulting in a deficit of 36,254 million pesetas, or 24 per cent of turnover. The annual deficits are financed by the Ministry via the Public Budget.

C.13.2 Some aspects of the Spanish post regulation

C.13.2.1. Independent regulatory body

In 1991 an important change was introduced in the Spanish regulation, the separation of regulatory functions from the provision of services¹⁷². Prior to 1991, both roles were performed by the General Directorate of *Correos*. After the reform, the regulatory functions were allocated to the General Secretariat of Communications, a body belonging to the *Ministry of Fomento*. Despite this separation, there is also a kind of ambiguity in the carrying out of these functions, as a result of the fact that the Chairman of *Correos* is the Chairman of

¹⁷¹ Source: *Correos y Telégrafos*' Annual report, 1996.

¹⁷² Law 31/1990

the Ministry of Public Works, which also controls the General Secretary of Communications¹⁷³.

C.13.2.2. Prices

Under the law currently in force, the general parameters to set prices for postal services are set in Parliament. Then *Correos* submit proposals to the General Secretary of Communication for price changes, always within the limits of these parameters.

Until January 1998 there was not a uniform tariff in Spain, and postal rates were lower for traffic posted and delivered within a particular city (urban tariff). A higher rate was charged for mail posted in one area and delivered in another (interurban tariff). A tariff rebalancing has been a consequence of a new commercial strategy by *Correos*, which nevertheless still faces competition in intra-urban traffic since 1960¹⁷⁴, which currently is especially intense. Despite this, from January 8th 1998 the two rates were combined. Direct mail¹⁷⁵ is also liberalised in Spain.

C.13.2.3. Investment

Money funds allocated to investments are set in *Correos*' budget, which are included into the Public Budget and consequently, are passed by Parliament. However, once Parliament approves *Correos*' Budget, the Spanish Post Office can freely allocate these funds across the organisation.

C.13.2.4. Return on capital

The existing regulation does not define any requirement on return on capital.

C.13.2.5. Standards of service

The existing regulation does not define any requirement on standards of service.

C.13.2.6. Numbers of post offices

In principle, *Correos* is free to close post offices (the total number declined from 11,938 in 1990 to 10,917 in 1996), but in practice there are significant pressures either by city councils or the Government against closures.

¹⁷³ The Ministry has delegated *Correos*' chairmanship on to the General Secretary of Communication (Ministry Order 26 February 1998)

¹⁷⁴ Article 10 of the *Ordenanza Postal*.

¹⁷⁵ Direct mail refers to those items whose contents, although addressed, are not personalised for the addressee (eg. some types of advertising)

C.13.3 Universal service obligations in Spain

C.13.3.1. The legal framework

The relevant legislation covering postal services is:

- Law of 22nd December 1953 de *Reorganizacion del Correo*;
- *Ordenanza Postal* dated in 1960;
- *Reglamento de Servicios de Correos*, Decree 1653/1964;
- Law 31/1990 of 27th December de *Presupuestos Generales del Estado para 1991*; and
- Royal Decree 176/1998 of 16th February.

Within the next six months a new law will be passed in Parliament, which incorporates several changes with respect to the current wording, including a definition of the USO.

The *Reglamento de Servicios* and the *Ordenanza Postal* oblige *Correos* to provide postal services, but there is no overall definition of universal service. Article 99 of Ley 31/1990 defines what are called basic (reserved) services (*servicios basicos*). These consist of the collection, sorting, transport and delivery of letters and postcards, telegrams, telex and postal and telegraph money orders. The interpretation of the wording of the law and of the *Ordenanza Postal* implies that urban letters are not included within the reserved service, only national and international mail. The rest of the services are not considered to be basic ones, and therefore can be provided by any other public or private entity that has the necessary administrative authorisation (article 99, law 31/1990).

C.13.3.2. Delivery obligations

The *Reglamento de Servicios*, article 245 and following, requires *Correos* to provide a daily delivery five days a week (Monday-Friday) in any area (either densely or sparsely populated) and for any type of addressee (either business or residential). There are twice-daily deliveries in some areas of Madrid, but this is the result of a commercial decision by *Correos*.

Correos has written obligation to deliver to;

- addressee's door, letters (of any weight¹⁷⁶) and other mail weighting less than 500 gr. For parcels weighting more than 500 gr. an extra-tariff must be released by the client so as to be delivered at the addressee's door¹⁷⁷;

¹⁷⁶ Items weighting more than 2Kg are not considered letters.

¹⁷⁷ Art. 251 of the *Reglamento de Servicios*.

- for blocks of flats, *Correos* has the obligation to deliver ordinary mail in the group of boxes installed in the building lobby¹⁷⁸;
- *Correos* also has to deliver ordinary and registered mail addressed to postal administration boxes;
- to *Lista of Correos*, the department which receives mail to people with no specific residence or unknown addresses¹⁷⁹; and
- hotels, travel agencies, schools and custom offices¹⁸⁰.

The Spanish regulation allows the existence of addresses to which deliveries are not made. Royal Decree 772/1980 states that: “for those scattered population settlements whose traffic is not enough to require a counter or a rural postman, delivery and collection of ordinary mail services could be established if users install rural mailboxes. According to *Correos* other exclusion criteria arises for unidentified address points.

C.13.3.3. *Other USO obligations*

Reglamento de Servicios article 189 and following require daily collection of mail. As stated above, Spanish legislation does not specify minimum qualities of service, but they are consequence of *Correos*' commercial strategy. To this respect, studies carried out by *Correos* show that the average delivery time in 1996 was 1.52 days for letters, 3.66 days for parcels and slightly longer than 24 hours for urgent letters. The percentage of mail meeting these delivery times was 91.9 per cent for letters, 90.3 per cent for parcels and 95 per cent for urgent consignments, as Table C.32 shows.

¹⁷⁸ Art. 253 and 254 of the *Reglamento de Servicios*.

¹⁷⁹ Art. 256 of the *Reglamento de Servicios*.

¹⁸⁰ Art. 267 of the *Reglamento de Servicios*.

Table C.32
Spain - Postal Items Delivered within the Target Delivery Time (percentage), 1996

Basic Service	Target Delivery time	Percentage delivered on time
Local	1 day	90.3
Provincial	2 days	92.6
National	3 days	93.2
Total (Average)		91.9
Economic Service	Target Delivery time	Percentage delivered on time
Local	3 days	97.7
Provincial	5 days	90.7
National	7 days	87.5
Total (Average)		90.3
Urgent Service	Target Delivery time	Percentage delivered on time
Local	Same day	80.1
Provincial	1 day	97
National	2 days	97.9
Total (Average)		95

Source: *Correos y Telégrafos. Annual report 1996*

The General Secretary of Communications also tests *Correos'* quality of service. The last test, carried out on ordinary letters, is shown in Table C.33.

Table C.33
Spain - Quality Control of Ordinary Letters by the General Secretary of Communications

	D + 1*	D + 2	D + 3
Urban	91.57	97.73	98.61
Provincial	62.07	88.54	95.29
National	30.26	67.9	88.45
Total (national)	55.10	89.9	92.85

D = date of postmark

Source: *Correos y Telégrafos. Annual report 1996*

In addition, *Correos* is required to deliver certain types of mail - newspapers, and periodicals - at lower rates. Braille material is carried free in line with UPU agreements.

C.13.4 Costs and USO burdens in Spain

C.13.4.1. Estimating the cost of USO of postal services in Spain

Neither the Ministry nor *Correos* have carried out any study estimating the burdens of the provision of USO. *Correos* has just started trying to estimate the cost of the provision of

services, so that they would be able to work out the cost of service provision in both rural and urban areas.

However, sources at the Ministry ranked "maintenance costs of the postal network in rural areas" as the most costly activity, followed by "delivery of parcels in rural areas" and "delivery of postcards and letters in rural areas".

C.13.4.2. Cost data

Correos were unable to provide any information about their actual costs,¹⁸¹ although they believe that the European Commission 1992 Green Paper proportion of 65 per cent for delivery costs may be rather too high.

The Ministry publish some statistics of postal traffics in Spain in their annual statistical report.¹⁸² These data include annual traffic mailed and delivered for the three types of traffic (*basicos, economicos, urgente*) in each of the seventeen autonomous regions of Spain.¹⁸³ We had hoped that we might be able to link these volume data with data on costs for the different regions, but this has so far not proved to be possible.

Consequently we are not able to provide any USO burden estimates for Spain in this Report.

¹⁸¹ Total annual cost and revenue data are published in Correos' 1996 Annual report.

¹⁸² Ministerio de Fomento *Anuario Estadístico 1996* Madrid, 1997.

¹⁸³ In addition, data are available on the two small North African territories of Ceuta and Melilla.

C.14. Sweden

C.14.1 Introduction

Table C.34
Sweden - Basic Statistics

	1992	1993	1994	1995	1996
Area of territory (km ²)	449,964	449,964	449,964	449,964	449,964
Population (thousands)	8,690	8,750	8,790	8,830	8,845
Population density (people/km ²)	19.4	19.5	19.6	19.7	19.7
Operating Revenue (MSEK)	21,032	21,664	21,609	22,271	22,725
Profit after financial items	1,413	1,363	1,401	831	570
Total number of Sweden Post employees at Dec 31	62,100	55,385	55,017	55,722	53,178
Average number of fulltime equivalents	53,345	50,213	46,937	46,048	45,137
Average number of deliveries per day in urban areas	1	1	1	1	1
Average number of deliveries per week in rural areas	5	5	5	5	5
Mail service (millions of items)	4,380	4,532	4,894	5,005	5,400
Per cent of mail delivered overnight	95	95	96	96	94
Number of post offices	1,773	1,473	1,341	1,289	1,177
Number of other service points	179	419	537	564	640
Total number of counters	1,952	1,892	1,878	1,853	1,817

Source: *Universal Postal Union Postal Statistics 1996 and Sweden Post Annual Reports*

Sweden Post is a publicly owned limited liability company. The government appoints the Board of Directors which in 1996 included a chairman, three union representatives, one government official, and five other members from private industry and public administration.

There are two main regulatory instruments governing Sweden Post's activities - the Postal Services Act (1993:1684) and an Agreement with the State which sets out Sweden Post's basic service requirements and sets a price cap for the domestic conveyance of letter services. Amendments to the Act come into force on 1st July 1998.

The Ministry of Transport and Communications decides overall policy in respect of the postal sector. It regulates some of Sweden Post's charges through a price cap and sets financial targets for Sweden Post on behalf of the state as owner. The National Post and Telecom Agency, an independent regulatory body, monitors licensed postal operators' compliance with the requirements of the Act and Swedish Post's Compliance with the Agreement.

Under the Postal Services Act ("the Act"), which took effect from 1 March 1994, there is no exclusive right to mail conveyance. Section 4 of the Act provides for a right to carry on a postal business¹⁸⁴ subject to an authorisation under the Act. Section 5 provides for an authorisation to be granted if postal businesses are to be conducted under conditions meeting reasonable demands of reliability and in such a way that protection of the personal privacy of senders and addressees is maintained.

C.14.2 Universal Service Obligations

Table C.34 sets out Sweden Post's formal service obligations. These cover three broad areas: provision of a universal postal service, social obligations and provision of universal banking services. We discuss each of these in turn.

C.14.2.1. Universal Letter Service Obligation

The universal service in Sweden is established in Section 1 of the Postal Services Act which states that:

"In Sweden there shall be nation-wide mail services ensuring that letters, other addressed mail items weighing less than 2 kg and parcels can reach everyone regardless of address locality. It should be possible for all to have such mail conveyed at uniform and reasonable prices. It shall, in doing so, be possible to insure mail and to obtain a receipt from the addressee showing that a mail item has been received.

In addition, there shall be nation-wide counter services enabling everyone to effect and receive payments at uniform prices."

Further to this, Section 3 of the Agreement sets out the requirement on Sweden Post to provide a good basic mail service at a uniform rate for single (or a few) items. However, this Section also notes that customer demand should be the governing factor when changes are made to the scope of mail services.

The Agreement does not spell out the point to which mail must be delivered. However, Sweden Post delivers mail to the addressees door, to post boxes of flats and to post office boxes. In areas served by a rural post-man, delivery is made at "delivery points" with groups of boxes. The rural post-man will make a detour if there are at least two houses within one km distance. If the distance from the letter box to the house is greater than 200m, as may be the case in some rural areas, then deliveries must be to the door. That is, no-one is expected to walk more than 200m to collect their mail.

¹⁸⁴ A postal business is defined in Section 3 of the Postal Services Act 1993 as one which refers to regular conveyance of letters, or of letters and parcels, in return for a fee.

Packages for households are delivered to the door or groups of boxes in rural areas. In urban areas they are delivered to the nearest post office. There are no specific delivery targets for packages, though we understand Sweden Post plans to have all parcels on a next day delivery service.

Section 3 of the Agreement also requires Sweden Post to provide a mail insurance service.

Section 5 requires that the number of permanent households which have access to mail services less than daily should not increase during the term of the Agreement.

Amendments to the Postal Services Ordinance came into effect on July 1st 1998. Under Article 8.2 Sweden Post is required to provide at least one clearance and one distribution of mail every working day. Under Article 8.3, at least 85 per cent of the mail which has been deposited for overnight delivery before the last clearance should be delivered the following working day, and at least 97 per cent within the three following working days.

C.14.2.2. Social Obligations

Sweden Post's social obligations are set down in its Agreement with the Government. They are as follows:

- Section 5.2 requires that "Sweden Post undertakes to provide discounted stamps to private individuals in easily available forms". This obligation ceased to apply from 1st July 1998;
- Section 8.2 states that "Sweden Post shall carry out defence planning measures for the total defence organisation, in return for cost based reimbursement";
- Section 9 requires "Sweden Post to undertake, at the request of the Post and Telecom Agency and in return for cost based reimbursement, to convey literature for the blind and to provide enhanced services to functionally disadvantaged persons in connection with postal services".

The Swedish State "contracts" with Sweden Post to provide various social services in return for payments to cover the cost of the obligations.

C.14.2.3. Payment Service Obligations

Section 4 of the Agreement sets out Sweden Post's requirements to provide daily basic counter services. Where these are not commercially justified the State undertakes to pay compensation to Sweden Post. As with mail services, the number of households with less than a daily counter service should not increase during the term of the Agreement.

Table C.35
Sweden Post's Service Obligations

Social responsibilities in letter service	Regional responsibilities in letter service	Regional responsibilities for payment services
Discounted stamps to private individuals ¹⁸⁵	Daily service - on week days, excluding holidays	Daily availability
Literature for the blind	Nationwide delivery - no more than 1,500 households may have less than a daily delivery service	Nationwide service
Subsidies for deliveries to old and disabled persons in rural areas	Uniform tariff for single items	
National defence planning		

Source: PTS

C.14.3 Reserved Service and Competition

Sweden Post operates in a fully liberalised environment. There are around 90 licensed competitors of whom about 60 are operational. Only one of these, City Mail, offers a service which competes for traffic over a wide geographic area (namely, Stockholm, Malmö and Gothenburg). Unlike Sweden Post none of new entrants has a universal service obligation.

C.14.4 Actual Service Provision

Sweden Post provides a daily delivery services (on working days) to all but 1500 households.

Sweden Post sets its own delivery target of 97 per cent next day delivery for first class mail. This target has been accepted by Government. In 1996, 94 per cent of all mail items and 95 per cent of first class mail was delivered the next day.

The average Swedish household spends 300 SEK/year on postal services. This is a small amount relative to average incomes and so services are judged to be "affordable".

The number of post offices has declined steadily over the last 5 years, though largely offsetting this there has been an increase in the number of other service points (see Table C.35).

The state sets a dividend which spends is expected to return each year. In 1996/97 this was set at an 11 per cent return on shareholders equity. This target was achieved.

¹⁸⁵ This obligation will cease from July 1998.

C.14.5 Regulatory Responsibilities

The Ministry of Transport and Communications has overall regulatory responsibility for the postal sector. It initiates legislation and has supervisory functions as owner of Sweden Post.

The National Post and Telecom Agency is responsible for:

- Supervision of the universal service obligation, the postal market and postal operators;
- Administration of undeliverable letters;
- Administration of the State's commitments in respect of social obligations and defence in the postal field;
- Participation on behalf of the Government in international activities, such as the UPU and CEPT/CERP.

Sweden Post sets prices subject to the price cap, sets its own service quality targets and determines its own investment requirements. The Ministry sets a minimum dividend for the company.

C.14.6 Costs and USO burdens

We have not received any detailed cost data from Sweden Post. Below we report aggregate information supplied to us by PTS and Sweden Post concerning the estimated costs of the different postal obligations.

C.14.6.1. Costs of the universal delivery

Concerning the letter service, Sweden Post argue that without an obligation they would continue to supply letter services on a universal basis, however, the level of service would be reduced. For example, on roads with a density of less than 3 households per km the letter boxes might be grouped together at the start of the road. We understand that the Government has employed consultants to examine the cost savings from this type of action.

Concerning parcel services Sweden Post may offer a service to the door on commercial grounds. They see this as a potential growth area for their business, as households increasingly order goods via the Internet.

In the absence of information from Sweden Post, we cannot provide our own estimates of the burdens of universal delivery in Sweden, though on broad demographic grounds we would expect some similarities, in terms of per cent of turnover, with Finland.

C.14.6.2. Costs of the Counters Obligations

Sweden Post regards its obligation to provide universal payment services as its most burdensome obligation. Transaction volumes have fallen rapidly - by 75 per cent - since 1979 and continue to decline at an annual rate of 8 per cent per annum.¹⁸⁶ The costs of this obligation are expected to continue to grow in future as increasing numbers of transactions are undertaken electronically.

In 1997, the Swedish Government paid Sweden Post 200m SEK for providing the counter service. Sweden Post claims and we understand that Government estimates also show that this sum is significantly less than the "cost" of providing uneconomic counter services. The Swedish Government is concerned about the costs of these obligations and has set up a special investigation to explore different ways in which payment services might be provided in future. The investigator has been asked to:

- Investigate approaches used to safeguard and finance the counter service elsewhere;
- Estimate the State's responsibility for counter services, including the appropriate service level and the costs of these services;
- Propose alternatives;
- Propose any legal changes that may be required.

Two approaches to measuring the costs of this obligation have been undertaken. The first involves estimating the losses made on counters offices where there is no bank in the surrounding area. This gives a cost of around 400m SEK. The second approach involves determining how many counter operations a commercial operator might continue to maintain and then calculating the net cost of the additional counter offices that Sweden Post is currently obliged to provide. We understand this gives a much higher cost of 800m-1bn SEK.

C.14.6.3. Costs of Social Obligations

In 1997, the Swedish Government made the following payments to Sweden Post to cover the costs of its social obligations:

- 37.7m SEK for the extended service (i.e. delivery to the door) for the disabled;
- 44.4m SEK for the distribution of Braille publications and other material for the partially sighted;
- 23m SEK for defence planning.

¹⁸⁶ Source: Sweden Post Annual Report 1996.

C.14.7 Financing the USO

At present Sweden Post's service obligations are funded through a mixture of cross subsidy and direct Government grants. The recent decline in the profitability of Sweden Post caused the Government to commission an independent study into the long-term financial conditions of Sweden Post.¹⁸⁷ Its response was to release a Green Paper proposing the introduction of a universal service fund financed through a charge of 3 Swedish öre on each letter delivered.¹⁸⁸ This approach was among other things found to be unconstitutional and has for the time being been abandoned.

¹⁸⁷ It is also worth noting that there has not been a change to the definition of the USO following liberalisation.

¹⁸⁸ One Swedish öre is one hundredth of a Swedish Krona.

C.15. United Kingdom

C.15.1 Introduction

Table C.36
United Kingdom - Basic Data

	1990/91	1991/92	1992/93	1993/94	1994/95	1995/96	1996/97
Area of territory (square kms)	241751	241751	241751	241751	241751	241751	241751
Population (thousands)	57681	57903.7	58098.9	58293	58500.2	58694	
Population density (people/km ²)	238.6	239.5	240.3	241.1	242.0	242.8	0.0
Post Office employees in thousands (at end year)	206	197	190	190	189	191	193
Average number of deliveries per week in urban areas	11	11	11	11	11	11	11
Average number of deliveries per week in rural areas	6	6	6	6	6	6	6
Number of households without postal delivery	0	0	0	0	0	0	0
Inland letter mail service (millions of items)	15306	15379	15137	15543	16138	17245	17296
Number of post offices	20638	20160	19958	19722	19607	19414	19251
Directly operated offices	1167	1019	917	800	699	653	606
Agency offices	19471	19141	19041	18922	18908	18761	18645
Revenue (£ million)	4719	5149	5345	5568	5878	6210	6370
Costs (£ million)	4602	4899	5081	5268	5444	5859	5893
Operating profit (£ million)	117	250	264	300	434	351	477

Source: Eurostats Demographic Statistics 1997, Post Office Annual Reports 1992/93 and 1996/97

The British Post Office is a nationalised industry reporting to the government ministry, the Department of Trade and Industry (DTI). There is no private shareholding in The Post Office, and no separate postal regulator. The Post Office Chairman and Board Members are appointed by the Government.

The Post Office is divided into four main business units, which have separate financial accounts. These four units are:

- Royal Mail, which is responsible for letter mail. In 1996/97 Royal Mail's turnover was £5,019 million, and profit £518 million;
- Parcelforce, which is responsible for parcels, and which in 1996/97 recorded a loss of £21 million on turnover of £457 million;
- Post Office Counters Ltd (POCL), which is responsible for the network of post office counters, most of which are actually operated as agencies. As well as dealing with postal matters, Post Office counters in Britain undertake a variety of tasks, including

banking (giro) services, payment of social security benefits, issue of motor vehicle licences, National Savings services, and (along with many other retail outlets) sale of national lottery tickets. In 1996/97 POCL recorded a profit of £34 million on turnover of £1,161 million. About 20 per cent of this turnover is associated with postal matters; and

- Subscription Services Ltd, which provides payment collection services to other organisations, and had a profit of £8 million on turnover of £71 million in 1996/97.

In recent years The Post Office has contributed financial surpluses to Government. These have been credited against the Public Sector Borrowing Requirement (PSBR), the Government's annual net financial deficit. The Post Office is set a financial target each year in terms of an External Financing Limit, or cash surplus. In the 1996/97 financial year this was £268 million which was met. Royal Mail is also set targets with regard to reduction in its real unit costs, and with regard to annual return on capital employed.¹⁸⁹ Parcelforce is set a target rate of return on capital, while POCL is set a target rate of return on turnover.

The previous Conservative Government had abandoned plans to privatise The Post Office in the face of political opposition. Since coming to power in May 1997, the new Labour Government has instituted a Post Office Review, which is under way in 1998. While the Government has said that it is firmly committed to retaining The Post Office in the public sector, the Review is concerned to identify ways in which The Post Office can be given more commercial freedoms. Major issues under consideration include options for partnership with the private sector, methods to ensure fair competition in postal services, the role of POCL in the delivery of Government services, and the programme of converting larger post offices to agency operation.¹⁹⁰

C.15.2 Definition of universal service obligation

The broad nature of the USO is defined in Section 59 of the British Telecommunications Act 1981. The Act stipulates that the Post Office provide services for the conveyance of letters throughout the UK to satisfy all reasonable demands for these services, unless these are provided by other persons or the provision of these is, in the Post Office's opinion, either impracticable or not reasonably practicable.

In fulfilling this obligation, it must have regard to the following:

- Efficiency and economy;
- Social, industrial and commercial needs of the State;

¹⁸⁹ In 1996/97 Royal Mail's target was 20 per cent, but the organisation actually achieved a 28.2 per cent return on capital employed.

¹⁹⁰ DTI Press Notice *Beckett Announces Commitment to Public Sector Post Office* 6th April 1998.

- Desirability of improving its operating systems; and
- Developments in communications and banking.

In practice, the Post Office defines the extent of its USO as "an obligation to provide at least a defined minimum quality of service at a **uniform** price to all customers". This commitment does not appear in any primary or secondary legislation. However, the means exist within current legislation for the Government to compel the Post Office to provide a satisfactory USO service if it felt that the Post Office's standards of service were insufficient.

The definition of the USO does not have to be entrenched in legislation. For example, a *Hansard*¹⁹¹ quote from 3 July 1997 provides a summary of the Government's expectation of what services should be provided by the Post Office and can be taken to be a binding definition of the USO:

The Government are committed to a nation-wide letter and parcel service with daily delivery to every address in the country, to a uniform and affordable tariff structure under which it costs the same to post a letter anywhere in the United Kingdom, and to maintaining a nation-wide network of post offices. Detailed arrangements for the provision of postal services at local level are the operational responsibility of the Post Office.

Note that this also defines both the minimum frequency of delivery, namely daily (for each working day) to every address in the country¹⁹² and imposes the obligation of a uniform tariff.

In further clarifying its views of the cost of the USO as "an obligation to provide at least a defined minimum quality of service at a uniform price to all customers" in its response to the present study, The Post Office noted:

The cost of the USO is not unique, it will be different for each set of market circumstances (e.g. extent of competition; regulatory controls imposed on the incumbent postal administration, etc). In any given situation the cost of the USO is a product of:

- disaggregation of the mails network into a matrix of routes based on dimensions such as content, collection/delivery mode and distance;
- evaluation of per unit long run avoidable cost associated with the provision of each different service/route combination;

¹⁹¹ The *Hansard* is a verbatim record of Parliamentary debates in the UK House of Commons.

¹⁹² Exceptions are permitted for reasons of extreme geography which relates to areas where no daily transport service exists, e.g. islands. The definition of these is subject to challenge by judicial review.

- comparison of this with the uniform affordable price at which service is actually provided and identification of service/route combinations where revenue falls short of avoidable costs; and
- calculation of the avoidable cost of the USO as the sum of total cost savings.

The dynamic cost of the USO will increase if additional competition is permitted, as competitive entry into profitable routes takes place below the uniform tariff the incumbent postal operator is required to maintain.¹⁹³

The Post Office has not made calculations of the actual costs of USOs under present (or future) circumstances, and is not currently able to assess where present USO costs in the UK are primarily incurred.

C.15.3 Reserved services

The Post Office's reserved area is defined by Sections 66 to 69 of the 1981 Act. According to Section 66, The Post Office is granted exclusive privilege with respect to the conveyance of letters and any incidental services arising from receipt, collection or delivery thereof.

However, Section 69 of the Act empowers the DTI, after consultation with The Post Office, to suspend the exclusive privilege to convey letters¹⁹⁴ for a certain period and to a specified extent. For example, on 15 October 1981, an order was made under this provision to suspend the postal monopoly in respect of all letters for which a sum of more than £1 was charged for delivery.

C.15.4 Actual service provision

Concerning deliveries, 89 per cent of customers receive two deliveries per working day (ie, Monday to Friday), while the remainder receive one delivery per day.¹⁹⁵ All customers receive one delivery on a Saturday. There is no stipulated time by which the first delivery must be completed.

Collections are made once a day on every weekday and on Saturday from all collection points. A number of centrally located boxes, principally those sited adjacent to post offices, are cleared once on a Sunday. From Monday to Friday, the frequency of collections (between one and eight times a day) and the timing of the last collection vary with population density.

¹⁹³ Post Office response to NERA questionnaire.

¹⁹⁴ Granted under Section 66(1).

¹⁹⁵ Second delivery should not be regarded as part of the USO. According to the 1994 Green Paper "The provision of a second delivery is not one of Royal Mail's social commitments but entirely an operational matter determined by Royal Mail at a local level". DTI *The Future of Postal Services* HMSO, London, 1994, p.21.

Performance data for deliveries shows that for 1995/6, 92.3 per cent of 1st class deliveries were made on the next day, while for 2nd class letters, 97.8 per cent were delivered within three days of posting. In 1996/7, these figures were 85.9 and 96.2 per cent, respectively, but these cannot be regarded as representative as they are affected by strikes.

While there is no obligation to deliver to any other delivery point such as a box at the end of a drive, a group of boxes or grouped PO boxes, the PO perceives there to be an unwritten obligation to deliver to the addressee's door. The operational criterion is to deliver to the addressee's door unless the customer requests an alternative arrangement such as a PO box.

All addresses in the United Kingdom receive mail delivery. Currently, 25.4 million addresses are served to the addressee's door, 100,000 receive delivery to roadside boxes and 400,000 are served to groups of boxes.

The frequency of actual delivery largely depends upon the population density of the area served. Densely populated areas ("urban areas") receive two deliveries a day from Monday to Friday, and one on a Saturday. Sparsely populated areas ("rural areas") receive one delivery a day between Monday and Saturday. In terms of percentages of delivered traffic, urban areas receive 89.5 per cent, while rural areas receive the remaining 10.5 per cent of letter traffic.

C.15.5 Regulatory responsibility

The Post Office has final responsibility for prices, investment, standards of service and the number of post offices. Whilst the Post Office has the power to set its own prices, in practice, changes are discussed with Government. The Government's views are factored into final PO decisions as part of the normal ongoing planning process. There are no criteria for assessing what is "affordable", a term used in the Directive 96/67/EC.

There is no fixed period specified within which tariffs must be revised. In recent years, letter prices have increased on average every two years, parcel prices annually. The criteria used to revise tariffs have included mainly the achievement of financial targets relative to projected movements in business finances and market conditions.

While the USO stipulates a uniform tariff, discounts are given for pre-sorted mail based upon avoided long-run marginal costs for work-sharing undertaken by the customer. Furthermore, certain user groups also benefit from lower tariffs. The PO is bound by a written obligation to offer its services free for the purpose of petitions and addresses to Her Majesty and to Parliament. It is also bound to deliver items for the blind free of charge. This is specified by the Universal Postal Union of which the UK is a member.

As indicated in Section C.15.2 above, the Ministry sets both the rate of return on capital and the profits payable to the Ministry of Finance.

C.15.6 Parcels up to 10 kg

For parcels, the USO requires delivery to the addressee's door. Similarly to letters, delivery is provided to all 25.9 million addresses in the country. The USO does not define the minimum speed of delivery for parcels. Performance data show that the proportion of parcels (standard service) delivered within three working days was 85 per cent in 1996/97.

C.15.7 Counters

Some three per cent (606) of the total of 19,013 counters are "own" counters in that they are staffed and owned by The Post Office. The rest provide services on an agency basis. Only the very largest post offices are staffed by PO employees. The balance of outlets consists of an agency network which covers a very wide range of office size, and both urban and rural locations. In the past, smaller and more rural outlets tended to be operated on an agency basis, but the Crown Agency Conversion programme has involved larger offices.

PO Counters Limited regards its network as an integrated whole and therefore analyses income and costs across the whole network rather than on an outlet by outlet basis. Its mission currently is to maintain its entire national network, accepting that many (perhaps even a significant number) of outlets will be operated at a loss. Only around twenty per cent of POCL's actual income of £1.1 billion is from postal business.

C.15.8 Costs and USO burdens

For the present study The Post Office supplied data on the attribution of costs to different functions for letter mail (Royal Mail) and parcels (Parcelforce) separately. These data for 1996/97 are shown in the Table C.37.

Table C.37
Cost Proportions for Royal Mail and Parcelforce, United Kingdom, 1996/97

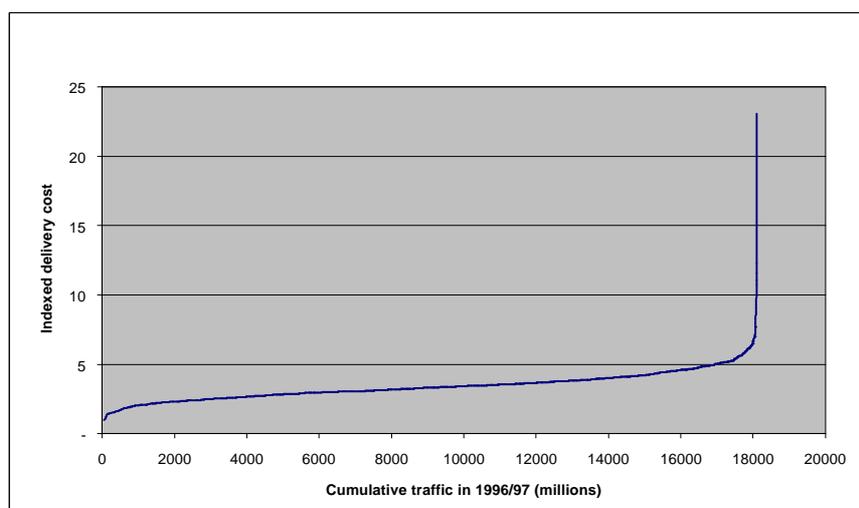
Proportions of costs (in per cent) for:	Letters (mail up to 2 kg)	Parcels
Collection/clearance	8.8	19.7
Outward sorting	17.0	8.1
Trunking/transport	6.5	7.6
Inward sorting	13.9	3.8
Delivery	38.4	47.5
Overhead costs not included in the above	15.3	13.3
TOTAL	100	100

The Post Office also supplied very detailed data on labour hours and total items of letter mail delivered in a sample week, in each of the total of 1,389 delivery offices in the United Kingdom. All the workers in these offices are engaged in delivery. The offices are grouped into nine regions and, for these regions, The Post Office also supplied information which enabled us to calculate average cost per labour hour in each region. This allowed us to

determine the average labour cost per item delivered in each of the 1,389 delivery office areas.¹⁹⁶ These could then be ranked in order of increasing size, while mail volumes were converted to estimated annual mail delivered in the financial year 1996/97, by assuming that each delivery office's share of total UK letter mail delivered during the full year was the same as in the sample week.

The resulting delivery cost index is shown in Figure C.9.

Figure C.9
Delivery Cost Index for the UK



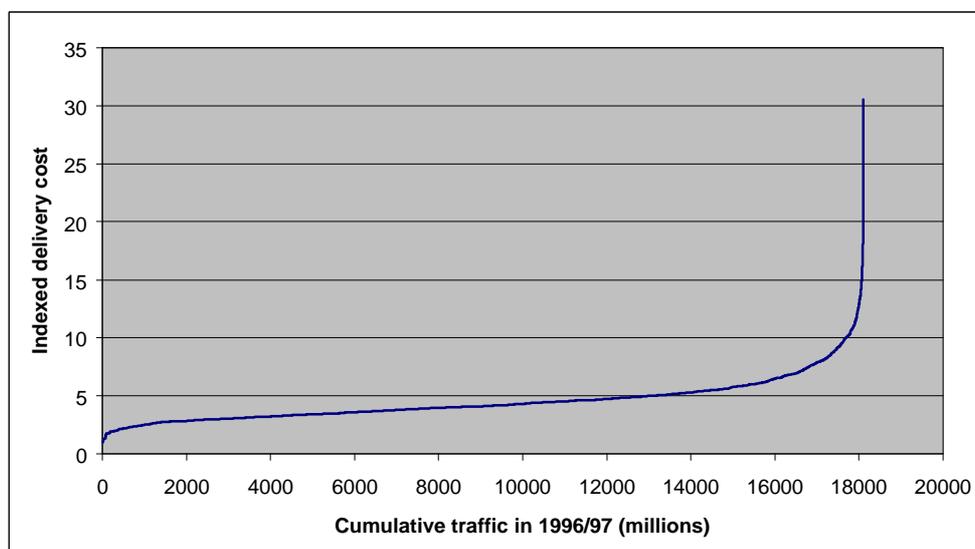
The Post Office have pointed out that this method might conceal variations in profitability within delivery office areas, so we tried to allow for this by further splitting each delivery office into urban and rural components,¹⁹⁷ on the basis of data which they supplied on the total numbers of addresses in each area classified as urban and rural. We then assumed that within each delivery office area the ratio between the productivity of urban and rural delivery (in terms of the numbers of individual items delivered per hour of staff time) was the same as the national ratio. Finally we also allowed for differences between the proportion of delivery office costs accounted for by labour and non-labour items in urban and rural delivery in the UK.¹⁹⁸ The resulting unit delivery cost curve is shown in Figure C.10.

¹⁹⁶ Labour costs are a little over 75 per cent of total delivery office costs in the UK.

¹⁹⁷ The definition of "urban" and "rural" is not a strictly demographic one, since Royal Mail define an area as "urban" if it receives two deliveries a day, and as "rural" if it receives one delivery a day.

¹⁹⁸ The Post Office estimate that just over 25 per cent should be added to labour costs to account for non-labour costs for urban delivery, and around 40 per cent for rural delivery.

Figure C.10
Delivery Cost Index for the UK with Delivery Offices Split between
Urban and Rural Components



In order to calculate USO burdens we have assessed avoidability of costs other than delivery using cost elasticities for different functions supplied by The Post Office. These are 0.05 for collection, 0.84 for both inward and outward sorting, and 0.31 for transport.¹⁹⁹

Under these assumptions, our model estimated the burden of the USO for letter mail in the UK, when delivery offices were not split between different components, as £ 166 million on a fully distributed cost basis, and as £ 5.3 million on a net avoidable cost basis. When delivery offices were split between urban and rural components, the burden estimates were £ 281 million on a fully distributed cost basis, and £ 22.6 million on a net avoidable cost basis.

These USO burden estimates represent respectively 3.6 per cent, 0.11 per cent, 6.1 per cent and 0.5 percent of Royal Mail's revenue from letter mail in 1996/97.

¹⁹⁹ We assume no changes in unallocated costs when traffics change.

APPENDIX D. ESTIMATES OF USO BURDENS FOR POSTAL SERVICES IN ITALY²⁰⁰

D.1. Introduction

This appendix carries out an estimation of the extra burden of USOs for services offered by Poste Italiane (PI). The methodology used is based on fully-allocated costs.

Before proceeding with the calculations, it is necessary to define which are the types of extra burdens derived from the USO in the Italian context. These include:

1. Those derived from the obligation of a uniform price covering all the universal postal services. These correspond to different costs on the various traffics which generate profitable and unprofitable outcomes;
2. Those derived from legal obligations or obtained through moral persuasion, to keep the tariffs for certain universal services low, even below cost (in Italy this includes press items and, indirectly, commercial invoices and packages);
3. Those derived from the existence of unprofitable post office counters, which a free-market operator would not be inclined to keep open.

In Italy, the cost of 3 above is conceptually distinct from the cost of 1 since the major activity of small unprofitable post offices is the provision of certain financial services (payments on current accounts, pensions, postal money orders) which have also been imposed by the universal service obligation, and to a lesser extent the provision of postal services.

D.2. Institutional Characteristics

Before examining these questions, it is important to underline an institutional aspect which characterises Italy as distinct from other EU countries. This is the actual, limited, extension of the reserved area (legal monopoly) for postal services. Press items, addressed advertisements and hybrid electronic mail (other than packages) are services which already enjoy free competition. In addition to this, the reserved area is limited by the existing distinction, laid down by law, which separates ordinary letters (part of the reserved area) *on the basis of content* from commercial invoices and from press articles which have the same external dimensions as letters but remain outside the reserved area. This has resulted in a situation in which private companies operate on the urban stretches of this market and leave the rural parts of this market to Poste Italiane. A part of the deficit incurred in particular services is a direct consequence of this situation.

²⁰⁰ Prepared for NERA by Vincenzo Visco-Comandini.

Due to this complex (and considerably confused) institutional framework, the extra burdens of USOs must be measured in a different way and will depend on the service to be considered.

In those postal services in which there is a balance of accounts or a profit, the extra burdens of USOs refer only to unprofitable activities (such as rural delivery).

In contrast, for universal services which present a comprehensive loss on the whole product, due either to legal obligations or moral persuasion to keep tariffs (press items and commercial invoices) low, or because of ill-considered commercial policies which maintain the obligation to offer a particular universal service, all of which have relegated operations to areas of low added-value (e.g. items sent one-by-one or low-value bulk mail) with prices which do not cover costs, the USO burden can be determined in two alternative ways:

1. As the difference between costs and revenues of the entire service. In this case, if the regulator maintains that it is in the public interest to offer this service (which, under these conditions, would not be offered by commercial operators), i.e. that USOs exist, then it would be up to the regulator to cover this difference. It should also be noted that the measurement of this difference should not be based on actual costs, which in certain cases would be inefficient, but on theoretically efficient costs.
2. As the cost of offering a particular service on non-profitable traffics, despite tariffs being augmented to cover overall costs.

D.3. Aspects of the Analysis

In principle the measurement of USO burdens requires data on costs and traffic volumes for each route (theoretically for each postman's round). In the case of Italy, notwithstanding current preparations on the part of Poste Italiane, a data base containing this type of detailed material covering all postmens' routes on national territory (such as costs, time to complete route, number of delivery points, number of mailed items, etc) is not available at a disaggregated level. However, it is possible to calculate the loss-making area determined by the services offered on non-profitable territorial segments. This can be undertaken by using appropriately-modified data from an internal study of Poste Italiane²⁰¹ which has calculated the difference in the costs of letter delivery in urban and extra-urban areas, for both ordinary and hybrid letters. The study has also estimated traffic volumes across various postal products.

In calculating the difference in delivery costs between urban and rural areas, Poste Italiane do not consider only final delivery, i.e. the activity undertaken by postmen from the time when they receive the letters in the post offices to when they deliver them to their final

²⁰¹ Poste Italiane, Divisione Servizi Postali (1996), Gruppo di lavoro per la determinazione dei costi di distribuzione del corriere ibrido, Roma

destinations, but instead also include the difference between the upstream costs which result from the need to transport and sort those letters in rural zones which are higher than those delivered in urban areas. Therefore, the high cost of delivering a letter in a rural area depends both on low productivity (number of letters delivered per worked hour or per point of delivery) and on large costs arising from the transport of letters from urban to peripheral offices and arising from sorting activities which are undertaken specifically for these traffics.

This wider concept of delivery defined in this way, coincides in large part with the activity required of Poste Italiane when they offer a service of downstream access, and has, in fact been used to fix access prices to the delivery network, recently imposed on Poste Italiane by the Italian competition authority for hybrid mail.

The cost of delivery in this wider context affects the total costs of letters, at a level of around fifty per cent. The proportion of costs accounted by delivery may be reduced because it appears that the problem of overstaffing²⁰² is particularly serious in the sorting phase, and in back-office work of post offices and is hence concentrated in the work phases preceding delivery.

Table D.1 illustrates the way in which Poste Italiane calculate the rural-urban cost differentials, based on the example of the costs and work phases for rural and urban traffics of the parcel service:

Table D.1
Poste Italiane's Method for Measuring the Costs of Parcels on Different Traffics

	fasi di lavorazione							direct costs
urban same city	C	IS	D					7560
rural same province	C	IS	TP	D				8960
urban same region	C	IS	TR	D				7700
rural same region	C	IS	TR	TP	D			9100
urban close region	C	IS	TN	OS	TR	D		10750
rural close region	C	IS	TN	OS	TR	AOP	D	12150
urban distant region	C	IS	TN	OS	TR	D		10750
rural distant region	C	IS	TN	OS	TR	AOP	D	12150

- C* = Clearance
IS = Inward Sorting
OS = Outward Sorting
D = Delivery
TP = Provincial Trucking
TR = Regional Trucking
TN = National Trucking
AOP = Additional Provincial Sorting

Source: Poste Italiane 1997, internal estimates.

²⁰² Poste Italiane estimates suggest overstaffing of around 20,000.

To estimate the USO burden, eight different categories of traffic were considered, all of which depart from one city:

- urban within the same city;
- rural within the same province;
- urban within the same region;
- rural within the same region;
- urban to a close region;
- rural to a close region;
- urban distant region;
- rural to a distant region.

These traffics reflect the geographical characteristics of Italy which arise from the way costs vary as a function of the physical distance between sender and addressee.

D.4. Estimation of USO Burdens in Postal Services and Parcels

All services defined by Italian law as having a universal character, hence, obliging Poste Italiane to deliver in all parts of the country, have been included in this analysis, namely:

1. lettere, cartoline, insured letters, recommended letters hybrid mail;
2. invoices;
3. printed matters similar to letters;
4. other printed matters; and
5. parcels.

To undertake the calculation, it was necessary to make some initial estimates because the official cost accounting system of Poste Italiane, as of 1996, is based on the activity-based costing method and furnishes data for each product with the costs incurred through the activities necessary for its production but not the differences in costs existing across diverse types of traffic. Therefore, these latter costs have been determined using a system of direct costing (the methodology of which is described in Poste Italiane, Divisione Servizi Postali, 1996) and refer to the difference in imputable delivery costs across the various areas of destination. This system has been calculated by PI for letters (normal and hybrid electronic ones) and, in a simplified form, also for parcels, but is valid for many other products which have similar costs. In order to apply this system, it is necessary to know the percentage of comprehensive traffic volume distributed over the eight types of traffic considered. Internal

Poste Italiane estimates have been used which incorporate administrative as well as revenue data.

D.4.1 Letters

Standard letters, postcards, registered, recorded and hybrid letters have been included in the same category as these are all characterised by identical delivery costs. The incidence of delivery costs for these products is homogenous and equal to 51.8 per cent of the total cost. It is assumed that for these products, a uniform price applies equal to the price of a letter, namely Lit. 843 (Lit. 800 plus the greater price for letters exceeding 20 grams). In the case of registered, recorded or hybrid (called POSTEL) letters, the effective unit revenue is greater because the service is of a value-added type with respect to normal letters, but these larger revenues (and the relatively larger costs) have been subtracted from the calculation.

The costs of delivery across the different traffics are given in Table D.2.

Table D.2
Post Italiane's USO Burden Estimates for Letters, Hybrid Mail and Postcards,
Fiscal Year 1997

	Unit delivery cost (lire)¹	Unit costs (lire)¹	Volumes (millions items)¹	Total costs (million lire)	Total revenues (million lire)	Total profit/losses (million lire)
Urban same city	293	698	683	476967	575786	98819
Rural same province	472	878	974	854794	821119	-33675
Urban same region	345	750	296	222065	249636	27571
Rural same region	524	929	452	420169	381213	-38956
Urban close region	369	774	162	125095	136188	11093
Rural close region	548	954	242	231081	204282	-26798
Urban distant region	391	796	303	241081	255353	14272
Rural distant region	570	975	303	295378	255353	-40025
Total	435	840²	3415²	2869401²	2878929²	9528

¹ Source: PI (1996), dati 1995 aggiornati al 1997

² Source: PI's ABC cost accounting system 1997

For this category, the unprofitable traffics are in rural areas (within the same province, region or in a different region) and generate a USO burden of Lit. 139.5 billion (bn) on a fully allocated cost basis.

We have undertaken a different analysis for invoices and press items, as these do not form part of the letters category in Italy (and, hence, one does not pay the ordinary tariff for these). Instead, they form two separate categories which are open to competition and command very low prices which are close to marginal cost in urban areas and represent subsidies to businesses, the principal clients for this type of mail. In the invoices market, Poste Italiane principally operate in rural areas as the urban ones are filled by private

agencies. In the market for press items, Poste Italiane commands a position of absolute dominance only by virtue of the fact that the price, in practice imposed by the Ministry, is less than the cost of providing the service.

In these circumstances, the calculation of the extra USO burden is undertaken in two ways: the first interprets the extra burden as an obligation to offer services without considering whether or not tariffs will be sufficient to cover costs; while the second interprets it to be the sum of the non-profitable traffics under the theoretical hypothesis that tariffs be fixed to cover the costs of the entire service.

D.4.2 Invoices

Italian legislation considers invoices to be a separate postal category, outside the reserved area. The market has evolved into two different traffics, urban and rural. The former is managed in large part by private firms, competing with Poste Italiane, which offer highly competitive rates but limit their activities to urban zones from which they derive profits. Poste Italiane has fixed two different prices for urban and extra-urban delivery, both of which do not cover their production costs.

Table D.3
Post Italiane's USO Burden Estimates for Invoices, Fiscal Year 1997

	Unit delivery costs (lire)¹	Unit costs (lire)¹	Volumes (millions items)¹	Total costs (million lire)	Total actual revenues (million lire)	Total actual profit/losses (million lire)	Total profit/losses with break- even price³
Urban same city	293	632	77	48953	25556	-23396	10988
Rural same province	472	811	165	133523	113880	-19643	-6149
Urban same region	345	684	68	46328	22362	-23967	6120
Rural same region	524	863	136	116950	93784	-23166	-12053
Urban close region	369	708	10	6855	3195	-3660	638
Rural close region	548	887	19	17180	13398	-3783	-2195
Urban distant region	391	730	5	3532	1597	-1935	215
Rural distant region	570	909	5	4399	3349	-1050	-653
Total	435	774²	484²	374631²	278194²	-96437²	0

¹ Source: PI (1996), data from 1995

² Source: PI's ABC cost accounting system 1997

³ Profit/losses if the price equalled cost

The USO burden for this service can be calculated in two different ways. If one maintains that the USO is a consequence of market liberalisation (which in Italy has always been liberalised in this area), then the cost is calculated as the difference between costs and revenues, i.e. actual losses, on all the traffics run by Poste Italiane, which results in a figure of some Lit. 96.4 bn. If, instead, one is interested in measuring

the theoretical cost of only the non-profitable traffics (which would emerge if the price was in a position to cover all the costs), this would result in a figure equal to Lit. 21 bn.

D.4.3 Printed matter similar to letters

Italian law classifies as press items all items identical, in dimension, handling phases and costs, to letters. The rationale for this appears to be so that lobbying organisations (in particular, publishing industries and public utilities) can benefit from low tariffs, thereby artificially reducing their costs. Poste Italiane are attempting to have this law changed in order to make these items part of the letter category. Given this situation, the difference between this and the price of a standard letter is to be considered a genuine USO burden.

The category of printed matter similar to letters, which formally does not exist, has been reconstructed here for the purposes of this report and in order to show the actual distortion in the fixing of prices which is reflected in the calculation of the USO burdens. This category's annual traffic volume amounts to 680m pieces, equal to 29.9 per cent of all items sent as part of the category of press items which, as previously indicated, are similar to and could be included in the letter category.

Italian law currently distinguishes three types of press items: press subscriptions (AP) which include newspapers and magazines, non-periodical press items (NP) and those which involve mail orders (VPC). Each of these categories commands different prices and the categories NP and VPC are further split into urban and rural. While AP does not distinguish between rural and urban, downstream access discounts are applied which by far outweigh real savings achieved by Poste Italiane.

Table D.4
Post Italiane's Printed Matter Similar to Letters, Fiscal Year 1997

	Unit delivery cost¹	Unit cost¹	Volumes (millions items)²	Total cost	Total actual revenues²	Total actual profit/losses²	Total profit/losses with break- even prices³
Urban same city	293	698	136	95027	31843	-63185	19308
Rural same province	472	878	191	167188	59611	-107577	-7118
Urban same region	345	750	49	36736	11463	-25273	4424
Rural same region	524	929	73	68277	22993	-45284	-6535
Urban close region	369	774	37	28661	8661	-20000	2438
Rural close region	548	954	56	52944	17372	-35571	-6295
Urban distant region	391	796	69	55235	16240	-38995	3076
Rural distant region	570	975	69	67675	21716	-45960	-9364
Total	435	840	680	571679	189899	-381780	0

¹ Source: same as Table D.2

² Source: PI internal estimates

³ Profit/losses if the price equalled cost

The USO burden determined by lower-than-cost prices for this class of postage is of the order of Lit. 381.8 bn, while the theoretical USO burden for unprofitable traffics (even if prices equalled costs) is of the order of Lit. 29.3 bn.

D.4.4 Printed Matter

In many countries, the existing discounted prices charged for sending newspapers are lower than "production" costs because it is maintained that it is in the public interest to distribute newspapers and magazines widely, as a cultural instrument. In Italy, as mentioned in the previous paragraph, various other products (NP and VPC) are categorised as press items, which should not receive subsidies but, thanks to special interest groups, have obtained the product status which allows prices to be charged below costs.

The unit cost considered in this report is not the official one derived from the ABC accounting cost system since this latter figure is considered excessive (Lit. 1,089) by the postal administration. For this reason, a figure of Lit. 650 has been chosen, which was felt by the postal administration to be more realistic and closer to the efficient value.

Estimation of revenues undertaken together with experts from the postal administration established an average price for all three categories, AP, NP and VPC, split by traffic types.

For items sent in the AP category, the Italian government conceded an annual compensation for Poste Italiane of Lit. 300 bn which, however, does not cover the deficit incurred to the extent of Lit. 735.5 bn for the whole press sector, which can be taken as constituting the USO burden for this sector.

Even if prices could be fixed to cover total costs, a deficit of Lit. 49.4 bn would nevertheless have been incurred on the unprofitable traffics.

Table D.5
Poste Italiane's Printed Matter (Newspapers, Periodicals and Other), Fiscal Year 1997

	Unit costs¹	Volumes (millions items)¹	Total costs	Total actual revenues¹	Total actual profit/losses	Total profit/losses in case of break-even²
Urban same city	447	135	60316	23583	-36733	27423
Rural same province	530	44	23548	8836	-14712	5354
Urban same region	455	19	8673	3329	-5344	3714
Rural same region	538	33	17937	6627	-11310	3740
Urban close region	635	197	125118	34403	-90715	2878
Rural close region	718	225	161940	44811	-117129	-15364
Urban distant region	635	434	275461	75742	-199720	6336
Rural distant region	718	500	359233	99404	-259829	-34082
Total	650	1588	1032226	296735	-735492	0

¹ *PI internal estimates*

² *Profits/losses if the price equalled cost*

D.4.5 Parcels

The market for parcels has been liberalised for a number of years now and Poste Italiane has been relegated to manage a "meagre" segment of it, including individual parcels (by private persons) and parcels sent by enterprises as loyalty gifts to their customers (points collection schemes). The Ministry has on a number of occasions either reduced or has procrastinated on Poste Italiane's request to increase the price for this service. Today, Poste Italiane registers losses in this market on all types of traffic.

Poste Italiane maintain that the difference between profitable and non-profitable traffics does not so much concern delivery (which they believe to be equal across areas and which results in around 37 per cent of total product costs in this case) as transport and sorting.

Table D.6
Post Italiane's Parcels, Fiscal Year 1997

	Unit costs (lire)¹	Volumes (millions items)²	Total costs (million lire)	Total actual revenues (million lire)	Total actual profit/losses (million lire)	Total profit/losses with break- even price³
Urban same city	7560	4	29367	22452	-6914	13352
Rural same province	8960	1	11465	7396	-4069	2607
Urban same region	7700	1	4223	3170	-1053	1808
Rural same region	9100	1	8733	5547	-3186	1821
Urban close region	10750	6	60918	32754	-28164	1401
Rural close region	12150	6	78846	37509	-41337	-7480
Urban distant region	10750	12	134118	72112	-62006	3085
Rural distant region	12150	14	174905	83206	-91699	-16594
Total	10997 (2)	45.7(1)	502576(2)	264146(1)	-238430	0

¹ Source: PI's ABC cost accounting system

³ Source: PI internal estimates

³ Profits/losses if the price equalled cost

The unit cost of Lit. 10,997 used for the estimation (and derived from internal calculations by Poste Italiane) is less than the official one based on ABC cost accounting principles of Poste Italiane, which amounts to Lit. 15,800. The latter figure is judged to be excessive by the postal administration as it includes expense items which do not form part of the service. Since the objective is to use the efficient cost where a systematic deficit arises, rather than the effective costs, we maintain that the figure of Lit. 10,997 is the appropriate one to use.

Also in this area, it is necessary to effect two types of USO burden calculations. The first calculation concerns the total losses registered by Poste Italiane for the management of the universal service, which was estimated at Lit. 238.4 bn. The theoretical USO burden on the non-profitable routes (which would remain unprofitable even if one applied a price to cover costs) is, instead, equal to Lit. 24 bn.

D.5. The USO Burden of Rural Post Offices in Deficit

In accordance with the *Contratto di Programma*, Poste Italiane undertook calculations of the USO burdens for 1995, 1996 and 1997 to complete a report on small post offices which are kept open for reasons of social consideration in spite of deficit operations. Poste Italiane received a transfer payment from the Ministry to cover the USO burdens of these peripheral post offices which amounted to Lit. 85 bn. In 1996 and 1997, these transfer payments were distributed across all services (postal, financial and telegraphic) and were treated as non-tariff revenues.

Table D.7
Post Italiane's Unprofitable Counters

number of unprofitable counter	3000
average cost of unprofitable counter*	100
average revenue of unprofitable counter*	20
of which postbank, payments, social security	15
of which postal services	4
of which freely undertaken services	1
average loss due to USO*	81
total loss*	243000
total loss due to USO*	231000
loss due postbank USO services*	182368
loss due to postal USO*	48632

* million lire

Calculation of the USO burden of unprofitable counters results in a figure of Lit. 48.6 bn for universal postal services provided by counters and in a figure of Lit. 182.4 bn for financial services such as the payment of pensions, postbank services and postal money orders. Poste Italiane estimate the USO burden of offering telegraphic universal services at Lit. 50 bn. This latter figure has not been included in the table.

D.6. Conclusions

Table D.8 presents a summary of the results obtained for the various services.

Table D.8
Post Italiane's Final USO Burden Estimates

	USO burdens at breakeven prices 1997 (million lire)
Unprofitable traffics:	
Letters	139,455
Invoices	21,050
Printed matter similar to letters	29,312
Printed matter	49,446
Parcels	24,074
Total of unprofitable traffics	263,337
Losses on unprofitable counters attributed to postal business	48,632
Total extra burden of USOs in Italy	311,969

Source: Sums of losses on unprofitable traffics at breakeven prices from Tables D.2, D.3, D.4, D.5 and D.6. Loss due to postal USO for counters from Table D.7.

As Table D.8 shows, the sum of the burdens for unprofitable types of traffic is equal to Lit. 263.4 bn. To this we must add the loss of Lit. 48.632 bn on unprofitable counters. This is that part of the loss on counters which is attributed to the postal business rather than to the postbank services which Poste Italiane counters also provide.

Post Italiane receives a sum of Lit. 300 billion from the Government as compensation for press items.

REFERENCES

Aligon, P, Cazals, C, De Rycke, M, Florens, J-P, and Marcy, S (1998) "The cost of sorting centres". Paper presented to the *Sixth Conference on Postal and Delivery Economics* presented by the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20.

Australian Industry Commission (1992) *Mail, Courier and Parcels Services* AGPS, Canberra.

Bradley, M D, Brehm, C S, Colvin, J, and Takis, W M (1998) "Empirical estimation of incremental costs for the US postal service". Paper presented to the *Sixth Conference on Postal and Delivery Economics* presented by the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20.

Bradley, M D, and Colvin, J (1998) "Productivity and technical change in a public service enterprise". Paper presented to the *Sixth Conference on Postal and Delivery Economics* presented by the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20.

Bureau of Transport and Communications Economics (1989) *The Cost of Telecom's Community Service Obligations* Report 64, Australian Government Publishing Services, Canberra.

Cave, M, Milne, C, and Scanlan, M (1994) *Meeting Universal Service Obligations in a Competitive Telecommunications Sector* Report to European Commission, DG-IV.

Cuthbertson, K, and Richards, P (1990) "An econometric study of the demand for first and second class inland letter services" *Review of Economics and Statistics* 72, 640-648.

Elsenblast, W, Pieper, F, and Stumpf, U (1998) *Estimating the Universal Service Burden of Public Postal Operators* WIK, Bad Honnef.

Elsenblast, W, and Stumpf, U (1996) "The cost of universal service obligations in a competitive environment" in Stumpf, U, and Elsenblast, W, eds *Cost of Universal Service: Papers Presented at the 3rd Koningswinter Seminar* WIK, Bad Honnef.

European Commission (1992) *Green Paper on the Development of the Single Market for Postal Services* Com(91) 476 Final, Brussels, 11 June 1992.

Golay, J, and Dobbs, I (1996) "Universal service obligation and reserved sector" in Stumpf, U, and Elsenblast, W, eds *Cost of Universal Service: Papers Presented at the 3rd Koningswinter Seminar* WIK, Bad Honnef.

Kolin, M, and Smith, E J (1998) "Mail volume and contribution on city delivery routes in the United States". Paper presented to the *Sixth Conference on Postal and Delivery Economics*

presented by the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20.

Kowalewski, K, and Muller, K (1996) "The cost of universal service obligation - the German perspective" in Stumpf, U, and Elsenblast, W, eds *Cost of Universal Service: Papers Presented at the 3rd Koningswinter Seminar WIK*, Bad Honnef.

Gallet, C, and Toledano, J (1997) *The Cost of the Universal Service in a Competitive Environment* La Poste, Paris.

National Competition Council (1998) *National Competition Council Report on the Competitive Restrictions in the Australian Postal Corporation Act 1989* Canberra, Australia.

OFTEL (1997) *Universal Telecommunication Services: Proposed Arrangements for Universal Service in the UK from 1997* OFTEL, London.

Rodriguez, F, Storer, D, and Smith, S (1998) "Estimating the costs of the USO in posts". Paper presented to the *Sixth Conference on Postal and Delivery Economics* presented by the Center for Research in Regulated Industries at Rutgers University, Montreux, Switzerland, June 17-20.

Tabor, R (1987) "Can competition pass 'go' with a natural monopoly?" *Public Finance and Accountancy* May 8th, p.11-13.

United States Postal Service (1998) *Summary Description of the USPS Development of Costs by Segments and Components: Fiscal Year 1997* USPS, Washington DC, June, Preliminary.

WIK (1997) *Costing and Financing Universal Service Obligations in a Competitive Telecommunications Environment in the European Union* Study for DG-XIII of the European Commission. WIK, Bad Honnef.