

**INTERNATIONAL PARCEL DELIVERY**

**ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT**

**Paris**

**55789**

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## **FOREWORD**

This document includes the proceedings from a Roundtable on International Parcel Delivery, as well as the background documents prepared for this event. The Roundtable was held on October 6, 1996, by the Committee on Consumer Policy.

The contents of this unclassified document fall under the responsibility of the OECD with the intent to bring this issue to the attention of a global audience.



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## **EXECUTIVE SUMMARY OF THE OECD ROUNDTABLE ON INTERNATIONAL PARCEL DELIVERY**

**held in Paris on 3 October 1996**  
*during the 52nd session of the OECD Committee on Consumer Policy*

The Roundtable on International Parcel Delivery was organised under the auspices of the OECD Committee on Consumer Policy<sup>1</sup>. The Committee's work is focused on the investigation of factors which are of crucial importance for the emergence of a global marketplace for consumers, including a cost-effective international delivery system. Empirical evidence has shown that the rates for international parcel delivery usually are significantly higher than the rates for similar domestic shipments over comparable distances. Unless ways are found to bring down substantially the cost of international parcel delivery, the potential for a global marketplace in tangible consumer goods will go largely unrealised. The growing variety of goods being offered to consumers around the world through open networks such as the Internet drives this issue home.

In order to broaden the understanding of international parcel delivery markets at the OECD, the Committee on Consumer Policy invited numerous experts to the October roundtable. They represented public post offices, private parcel delivery firms, mail-order companies, consumer organisations, research institutes and international organisations. The strong outside participation highlights the importance of this issue to governments and the business community.

The October Roundtable consisted of four sessions each of which was introduced by a brief lead presentation and followed by a general discussion. The first session, "Main Issues in International Parcel Delivery", highlighted some key features of international parcel markets and showed that the factors which impact on parcel rates are complex, including international and domestic regulations, market shares, cross-subsidies, customs and value added tax collection procedures, transportation costs, security provisions and maintenance costs for trucks and airfleets.

The second session, "Specific Cost Factors in International Parcel Delivery", was largely devoted to the costs incurred by customs and value added tax procedures. In this session, a representative of a national postal system argued that the administrative costs imposed on parcel delivery firms for the collection of value added taxes and import duties at the border accounts for a significant proportion of international parcel rates. Various policy approaches for simplifying such procedures were discussed, including the Canadian Low Value Shipment Program, which offers simplified and more cost-effective tax and customs treatment for goods with a value of less than CAN \$ 1600. The exchange of views during the general discussion showed that other approaches, which also facilitate more cost-effective customs and value added tax collection, are successfully applied between Nordic countries. Moreover, several national post offices are in the process of developing special consignment package programmes, involving shipments to Eastern Europe, which reduce the administrative effort for the procedures at the border.

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1. This roundtable is a follow-up to the 1994 OECD conference "A Global Marketplace for Consumers" and to a first discussion on issues related to parcel delivery held in June 1996.

The third session, "The Significance of Scale Economies and Economies of Scope", focused on whether there was potential for lower prices through increased volume or joint delivery of parcels and letters. Participants agreed that some scale economies are prevailing on the markets for parcel and letter delivery. In particular, significant scale economies in the final delivery leg are yet to be achieved. The discussion showed, however, that economies of scope through the joint processing of parcels and letters may not be substantial. According to the experts' comments, the collection, sorting and transportation of letters and parcels do not exhibit major economies of scope.

In the final session, "Policies for More Efficient Delivery Services", reform of postal monopolies was argued for by some, along with the practice, asserted to be widespread, of cross-subsidisation from letter services into parcel markets. Finally, some argued for a more flexible pricing policy in universal service areas. In this context, the European Commission's proposals for reform attracted particular attention.

The Roundtable served to help participants better understand the functioning of parcel delivery markets. Specific conclusions, moreover, could be drawn in some areas: that significant further scale economies are possible to achieve in the final leg of international parcel delivery and that current customs clearance procedures and procedures for the collection of value added taxes and customs duties add a significant if not yet fully quantified amount to the cost of delivering each parcel. If these administrative costs could be reduced, further cost reductions could follow if volume were then to grow and scale economies were to be achieved.

The Committee decided to build on this and to address the issue again in Autumn 1997 with a focus on customs clearance procedures and procedures for the collection of value added taxes and customs duties.

## INTERNATIONAL PARCEL DELIVERY: MAIN ISSUES FOR DISCUSSION

(Note by the Secretariat)

### Introduction

Parcel delivery services around the globe are challenged by fierce competition and the rapid growth of international trade. Private firms and consumers are increasingly operating on a world-wide scale rather than within national boundaries. This constitutes a need for adjustment in order to ensure a cost-effective and speedy delivery of parcels and packages. At the 1994 conference "A Global Marketplace for Consumers" the OECD has addressed these issues already: "Costs and delays associated with cross-border parcel delivery can be a major disincentive for consumers wanting to make purchases from other countries". Empirical evidence has shown that the rates for international parcel delivery usually are significantly higher than the rates for comparable domestic shipments over the same distance. Furthermore, the prices for parcel delivery that private firms charge generally are higher than the prices of public suppliers.

The total cost for sending a parcel from one country to another basically can be analysed in accordance with three basic steps in the delivery process, namely the processing in the country of departure, the processing in the country of destination, and the processing between these two countries. According to this categorisation the following cost categories appear to be most significant:

- i)* First, costs are associated with processing the parcels in the *country of departure (A)*, where the parcels are collected, weighed, stamped, and labelled. Moreover, the items have to be sorted and transported, for example, to some airport which is the gateway to international transport and delivery.
- ii)* Second, specific *costs of international delivery* arise from international (air) transport between the country of departure (A) and the country of destination (B). If the items in question are subject to import duty, customs clearance procedures have to be applied. Furthermore, the collection of value added tax involves some administrative effort. Such procedures generate costs which add to parcel rates.
- iii)* Third, in the *country of destination (B)* the parcels are transported and sorted again. Finally, they are delivered to the local recipients. At this end of the delivery process, the cost and price situation might largely depend on whether the service includes door to door delivery or the transport of parcels to collection points.

In June 1996 an exchange of views on many of the issues mentioned above between the OECD Committee on Consumer Policy, private carriers, the Universal Postal Union, and other participants was held at OECD headquarters in Paris. The meeting has emphasised the need for further investigation into parcel delivery markets. In order to gather additional information, Delegates therefore have decided to host a roundtable discussion on 3 October 1996, which shall serve further enhance the dialogue between public post offices, private delivery services, consumer federations, research institutes, direct marketers, and international organisations. This will help to broaden the stock of knowledge available for future work. Delegates are invited to provide information about all economic and regulatory aspects of interest in parcel delivery and postal services. These could include, for instance, input and output quantities and prices, as well as market shares, and information about the regulatory situation.

In the light of this the short-term objective of the roundtable is to provide a forum which enables participants to continue the exchange of views that has begun at the Global Marketplace Conference in 1994. The roundtable therefore can be regarded as a “fact finding conference” which helps to prepare the ground for a more comprehensive investigation of parcel delivery markets. The medium-term objective of the OECD parcel project, however, is to provide research based policy recommendations which help to raise the efficiency of parcel delivery. This will be to the advantage of the final consumer and at the same time benefit the parcel delivery industry and direct marketers.

The roundtable consists of four Sessions, the first of which aims at providing an overview over some basic features, as for example, the relevant market, the competitive situation, and cost structures. Session II will deal with specific issues related to international parcel delivery and primarily address the cost of customs and tax procedures as well as the cost of international transport. Session III deals with economies of scale and scope, the latter of which to a large extent influence the benefits from demonopolising postal systems. Session IV provides room for a discussion of recent policy moves in Member countries. It is important to keep in mind that, although parcel delivery is at the focus of the roundtable, the economic linkages between the markets for letters on the one hand and parcels on the other, necessitate a comprehensive approach. This is the case in particular as far as Session III (The Significance of Scale Economies and Economies of Scope) and Session IV (Policies for More Efficient Delivery Services) are concerned.

### **Session I: Main Issues in Parcel Delivery**

The parcel delivery industry has realised buoyant growth over the past few years. A strong increase in the volume of business and a healthy profit situation went hand in hand with substantial investment in modern production technology. Rising real income in many industrialised countries and an increased significance of the direct marketing industry may have contributed to that trend. Today the four leading private sector companies on the markets for parcel delivery and express shipments have around 500.000 employees world-wide.

A common feature of parcel markets in Member countries is that the rates for international shipments usually are significantly higher than the rates for comparable domestic services. For instance, shipping a 3 1/2 KG parcel with the United States Postal System from New York to London is more than two times as expensive as a shipment from New York to Los Angeles, although the distance is similar. In some cases international shipments can be about four times as expensive as domestic delivery over comparable distances. Furthermore, the prices for parcels that private firms charge in general are higher than the prices of public suppliers. The observed price differentials raise the question of which factors determine parcel rates, and which policies should be adopted in order to facilitate lower prices for parcel delivery.

One of the most controversial issues in parcel delivery deals with the size of the firms' market shares. In some Member countries, public post offices seem to hold relatively large market shares. Particularly illustrative is the situation in Germany, where two alternative concepts for the definition of the relevant market are discussed. Private firms base their calculation of market shares on a narrow definition. In this case the potential volume of internal freight transport systems of secondary sector firms (for example producers of electronic components who send parts internally) are not taken into consideration. The German public post office, Deutsche Post AG, under this assumption holds a market share of 68 %. An assessment of the relevant market by the Deutsche Post AG, however, leads to different results. The Post AG bases its estimates on the entire volume of goods transport services in Germany which also includes shipments by the internal transport services of private sector corporations. Many large companies

have invested in large-scale transport facilities that ensure the timely delivery of inputs in order to continuously feed the production process. Obviously, the Post AG considers this as a market that in principle can be exploited by specialised parcel transport services. In this case the market share of Post AG accounts for some 27 %.

Independent of the definition of the relevant market the public post offices in most countries seem to hold an overwhelmingly large market share as compared with private parcel delivery firms. This might be a result of comparatively low prices for shipments with the public post offices. Despite various inefficiencies associated with public ownership and public employment legislation, the public post offices normally supply parcel delivery at cheaper rates than the private competitors. This might point towards cross-subsidisation from the mostly monopolised markets for letter freight into parcel delivery. Against this background the question if regulatory reform could contribute to establishing a “level playing field” on the market for parcel delivery seems to be appropriate.

- i) An international comparison of costs and the volume of business in parcel delivery indicates that the United States market is both more cost-effective and substantially larger than comparable markets in other industrialised countries. This might be attributable to a greater degree of deregulation and flexibility on the market for shipments in the United States which benefits not only the parcel delivery industry but also direct marketers and the final consumers. In the light of this, what is the growth potential for parcel delivery and direct marketing in other countries?***
- ii) Administrative procedures and regulations exert an impact on the cost situation. What procedures and regulations are most important in terms of costs?***
- iii) What is the size of the relevant markets for parcel shipments in Member countries? Are there different concepts for defining the relevant market? What are the market shares of individual firms on domestic markets?***
- iv) On the market for international shipments a limited number of carriers seem to hold a relatively large market-share. How large is the aggregated market-share of the leading five carriers? Can the structure of parcel delivery markets be considered as being oligopolistic?***

## **Session II: Specific Cost Factors in International Parcel Delivery**

The administrative costs of collecting import duties and value added taxes lead to a loss of economic welfare. Costs are generated, for example, at the firm level resulting from the administrative paperwork that has to be done. Furthermore, also the final collection of duties requires some effort. Additional welfare losses result from the impact customs clearance procedures exert on the delivery time. Substantial delay as a result of relatively time consuming customs clearance seems to be normal. Finally, public authorities have to provide resources in order to facilitate the collection of import duties and taxes.

The Canadian Low Value Shipment Program was developed with a view to reducing the costs of collecting taxes and import duties. The program allows bonded carriers with a physical presence in Canada to collect duties and taxes levied on shipments with a value of less than CAN\$ 1600. For example, a mail-order company which is located in the United States, can ship the goods into Canada by using the service

of a bonded Canadian carrier. Taxes and duties are collected by the direct marketer. Then the revenues are transmitted to the bonded carrier, who is responsible for accounting and paying the duties to the Canadian authorities. One should keep in mind, however, that the different treatment of low value and high value shipments might lead to distortions. Since the administrative cost and the delivery time of low value shipments decrease relative to high value shipments, the program affects relative prices as well as the quality of service in the mail-order business.

From the viewpoint of welfare economics, an elimination of customs duties is the optimal approach. Duty free thresholds might be regarded as a step towards a complete abolishment of tariff-barriers to trade. However, they apply only to a limited market segment up to a certain value of the goods in question. For example, the European Union allows duty free imports up to a goods value of about \$ 28 (22 ECU), and for imports into the United States a duty free threshold of \$ 200 applies. The different treatment of goods below and above the duty free threshold, however, leads to similar distortions as described in the context of the Canadian Courier Program. The structure of relative prices is artificially affected by selective liberalisation, and households as well as firms might adjust their consumption pattern to the new price relations. A comprehensive free trade solution would avoid such distortions.

The international transport of parcels in principle can be carried out either by air, road, rail or marine transport. Each of these possibilities have their specific comparative advantages. However, air transport seems to be prevailing as far as long distance shipments are concerned. Transport via railway systems and road transport can be assumed to be competitive in particular if the geographical extension of the countries in question is not too large. This might be the case, for instance, in Europe where a parcel could take its way, for example, from Austria through Germany into the Netherlands, and the distance shipped would still be comparatively short.

The cost for transport seem to account for a large share of international parcel delivery cost. This is the case in particular for relatively heavy parcels which are transported over long distances. Although some deregulation of transport markets has led to significant price reductions in the past, particularly as far as air transport is concerned, a potential for further deregulation might exist.

- v) **To what extent can the relatively high rates for international parcel delivery be attributed to the administrative cost of customs and value added tax procedures? Delegates are invited to provide information about the cost impact of such procedures.**
- vi) **Can Delegates identify specific policy options which are appropriate for reducing the administrative burden of tax and customs procedures? What are the possibilities for sellers to collect taxes and duties levied by the importing countries? Could sellers pay taxes and duties in lump sums directly to the importing countries, making cross-border transactions effectively transparent? What cost savings to parcel delivery firms, tax authorities, and final consumers would result from such procedures? Could the Canadian Low Value Shipment Program serve as a model for other countries?**
- vii) **Are duty free thresholds an appropriate instrument for reducing the administrative cost of customs procedures? Do Delegates share the view that a selective liberalisation of trade, for example, on the markets for low value shipments leads to distortions of relative prices?**

- viii) The expenses for international transport seem to be a significant cost factor which contributes to high international parcel rates. Are Delegates in a position to provide estimates on the order of magnitude of such costs?**
- ix) Could regulatory reform of markets for transport by air, road or railway contribute to lower international parcel rates? From a political point of view can Delegates identify a potential for further deregulation of transport markets?**

### **Session III: The Significance of Scale Economies and Economies of Scope**

Scale economies are among the most important factors that influence the size and the number of firms operating on a certain market. Higher levels of output facilitate a reduction of unit costs, because fixed investment expenditure per unit of output decreases. Additional product-specific scale economies can be reaped if mass-production allows for an extended specialisation of workers. Economies of scope might be another important feature of the production technology employed in postal services. A firm can reap economies of scope if joint production of several distinct products is more cost effective than the production of each item in isolation. For example, in all main product categories, such as letter freight, postcard and parcel delivery, modern transportation machinery is needed. A use of transport facilities for combined delivery therefore might lead to a reduction of unit costs. Another source of economies of scope might be the simultaneous use of administrative and computer facilities (for example in wage and tax accounting) for the management of resources employed in letter and parcel delivery. In various Member countries, however, joint transport and delivery of distinct items can only be done by the public competitor, because the transport of standard letters is reserved for the public sector.

Future developments in the markets for postal services, however, might lead to a relative decline of letter freight, which could limit the potential for economies of scope. In fact, the extent to which economies of scope in Member countries' postal systems exist, very much depends on the effects of modern telecommunication technology on letter freight. Recent research has shown that the transition of information in particular via telefax results in a substitution of letter mail. One should keep in mind, however, that the total impact of modern telecommunication technology on the volume of letter freight could be ambiguous. It is possible that the strong growth of, for example, fax and email communication stimulates a complementary increase of letter mail. Hence, to a certain extent even a process of mail creation could be triggered. The significance of the mail substitution and creation effects very much depends on relative prices of traditional letter freight and modern telecommunication media.

- x) Production costs in parcel delivery seem to follow a falling pattern over substantial output ranges. Do Delegates share the view that scale economies are a common feature of the production technology employed in parcel delivery?**
- xi) Economies of scope might be reaped via a joint delivery of letters and parcels. Can Delegates identify economies of scope in collection, transport, or local delivery of parcel and letter freight? Does mail substitution by modern telecommunication technology erode the potential for economies of scope?**

#### **Session IV: Policies for More Efficient Delivery Services**

National case studies and other country specific material indicates that the regulatory frameworks of OECD Member countries' postal systems have some important properties in common. In most countries a state-owned post office has certain monopoly rights (primarily letter and postcard delivery), but at the same time is obliged to provide universal service on other markets (primarily parcel delivery and express mail) without the protection of a monopoly regime. The lack of competition resulting from monopolistic protection leads to cost-inefficiencies. In addition, public ownership of postal services raises production costs due to inflexibilities and a distorted incentive structure.

In some Member countries the reform of postal systems is an issue of intense discussion. Given modern technological developments (e-mail, fax, etc.), the traditional postal services are facing increased competition. Moreover, political developments, for example in the European Union, point towards significant changes over the coming years. In the light of this the following questions seem to be of particular relevance:

- xii)* Are there any new policy initiatives in Member countries which aim at reorganising postal systems? Is the efficiency of postal systems an issue under consideration by national consumer federations or other interest groups?**
- xiii)* Do the reserved areas for public post offices prevent private parcel delivery firms from reaping economies of scope? Is there a need to reconsider public monopolies in letter freight in order to achieve lower prices both for letter and parcel freight?**
- xiv)* Universal service obligations on certain markets for postal services might be appropriate. The scope of such obligations, however, could differ. For example, a uniform price regulation is not necessarily a first best solution. Is a more cost-related and flexible pricing policy necessary?**

## **ROUNDTABLE ON INTERNATIONAL PARCEL DELIVERY - 3 OCTOBER 1996 SUMMARY OF PROCEEDINGS**

**The Chairman, OECD Committee on Consumer Policy**, welcomed the approximately 40 experts attending the meeting. In addition to all the Delegates of the Consumer Committee, attendees included representatives of: the parcel delivery industry; public post offices; direct marketing groups; research institutes; and international institutions. There were four presentations, each followed by a discussion. The speakers were:

- Session I -- Mr. Anton VAN DER LANDE, United Parcel Service, Brussels
- Session II -- Mr. Thomas PUSCH, Director, International Freight, Deutsche Post AG, Bonn.
- Session III -- Ms. Phillipa MARKS, Director, National Economic Research Institute, London.
- Session IV -- Mr. Torsten ZILLÉN, Director, International Relations, Swedish Post.

The decision to examine the issue of international postal delivery derives from the fact that as the global economy expands, the Consumer Committee's consideration can no longer be limited to a local perspective, but must encompass the world. Initiatives are freeing commerce and trade, giving freer access to markets, yet at the same time affecting consumer interests. The impacts on consumers of these trends are not necessarily negative but they certainly do deserve scrutiny. Consumers, responding to declining telephone costs or to Internet access, are shopping globally. Parcel delivery is changing as consumers can order and shop remotely. These changes raise issues regarding delivery of goods. If cross-border delivery is too costly, consumers will forego purchases. An examination as to whether there are factors inhibiting market development is warranted.

Two points should be noted regarding the meeting's papers: 1) the examples of Canada and the United States have been used to illustrate comparative international prices in parcel delivery; 2) administrative factors in the collection of customs and value-added taxes may add unnecessary costs to consumer parcel delivery; it is important to seek a way to make transactions more efficient.

### **Session I**

#### **UNITED PARCEL SERVICE: "MAIN ISSUES IN INTERNATIONAL PARCEL DELIVERY"**

The United Parcel Service (UPS), serving 200 countries, is the largest parcel delivery service in the world. It employs 350,000 people, approximately ten per cent of whom are in Europe. In 1995, UPS had revenues of over US\$ 21 billion, of which US\$ 3 billion resulted from international business, and delivered 31 billion parcels and documents.

The express market is composed of time-sensitive shipments delivered within one to three days and with a weight of up to 70 kilos. It includes door-to-door delivery of letters, documents and packages. The cross-border part of this market, which has increased 60 per cent since 1993, is estimated to be 1 million pieces daily and is expected to grow at least 15 per cent per year. Integrators (private express parcel firms) have close to 75 per cent of the cross-border market. Postal services have 9.5 per cent. This share is not the totality of what the post office carries, but only what it carries as an express product. In Europe, postal services have five per cent and integrators have close to 80 per cent of this market and in the Asia-Pacific region, over 16 per cent. In the US, the country with the lowest prices and greatest competition, integrators have almost 80 per cent of the market for packages originating in the US.

In the global market pieces per day, the Asia-Pacific region has the largest number of shipments, followed by Europe, then US, Canada and the rest of the Americas. African volume is still insignificant, although there is the prospect that packages originating in South Africa will increase. In addition to UPS, major global players include Federal Express, TNT, DHL, EMS, Emory, Airborne and some large freight forwarders such as Kuhne & Nagel, Danzas, Panalpina, Thyssen, Haniel and Schenker. Boeing estimates that international air express was five per cent of revenue in tonne per kilometre of the total air market in 1995 and will grow 18 per cent annually to reach 37 per cent of the total air market by 2015. According to the Wall Street Journal, integrators in the US domestic markets had about 92-93 per cent of the overnight market for packages weighing between three and 70 pounds. Of the overnight letter market (weight below 2 pounds) integrators had 87 per cent.

Europe, with a population of 320 million inhabitants, has the potential to become the world's greatest express parcel market. Since the removal of European borders in 1993, the value of its internal trading has grown by 43 per cent from US\$ 1,500 billion to over US\$ 2,200 billion. Distribution service in Europe is an annual volume of US\$ 25 billion, including: US\$ 6 billion for express documents and packages within Europe -- primarily next day delivery; US\$ 2 billion of express documents to non-European destinations; and US\$ 17 billion of European non-express packages and documents (excluding letters) for domestic and cross-border delivery. In total, an estimated 11 million documents and packages weighing up to 70 kilos are shipped daily within Europe and from Europe to the rest of the world. The largest segment of this market is packages moving within national boundaries. Less than ten per cent of the industry's volume is shipped across European borders, although this segment represents a far greater share of revenues.

There are two categories within the cross-border market: express and non-express. Express deliveries are time-sensitive, next-day deliveries (often morning delivery) done to most business areas of Europe. The express sector within Europe, currently valued at US\$ 6 billion, is expected to have annual growth of over ten per cent. UPS estimates that by the year 2000, this sector will have a value close to US\$ 10 billion. It sees the greatest potential for revenue growth in the express cross-border market. In contrast, both the national express and the non-express cross-border markets are extremely fragmented with a large number of national operators -- specialists and niche players who compete aggressively with relatively low margins.

Questions are periodically raised as to why, within the express industry, private operators are more expensive than post offices. One reason is the unequal treatment of public and private operators in many countries. Post offices may receive preferential treatment from international customs authorities or not have to charge VAT on competitive products. Post offices may also be exempt from or not subject to the same rigorous application of laws in many countries. They may have preferential treatment regarding a myriad of national and local regulations such as loading and unloading restrictions in urban areas, technical and emission standards for delivery vehicles, or cumbersome employment limitations. Strict conformance to these regulations can be costly.

A further cause of costs difference is cross-subsidy, an anti-competitive tactic by which post offices use excess revenue, generated from their reserved area monopoly, to provide subsidies for services offered in the non-reserved competitive area. Deutsche Post AG serves as an example as its cost of delivering a domestic letter is probably not equal to the Dmark charged. Another example of cross-subsidy is the Dutch Post Office (KPN) which recently announced its acquisition of the express carrier TNT for over \$US 1.5 billion. Since the Dutch Post Office is a monopoly service provider with most of its competitive services making losses, it appears that acquisition financing came from reserves accumulated from monopoly profits. UPS contends that this is cross-subsidy and represents unfair competition. If post offices competing in non-reserved areas were subject to the same rules and restrictions as UPS and if the post offices were banned from using cross-subsidies to support their express parcel business, their prices would be higher than those of UPS. The integrators are lean, efficient companies not receiving any preferential treatments. Ending cross-subsidies would benefit consumers.

The definition of the relevant market should include businesses which are truly subject to competition. Application of this definition shows that in Germany, the Post Office has 68 per cent of the market and not the mere 27 per cent it claims. Unfair competition is one reason why the private sector is still behind in volume and has difficulty achieving economies of scale to yield reduced costs. In the US, the country with the most open and fair competition, some of UPS's domestic rates are significantly lower than those of the post office for equal service levels. UPS's rates would be even lower were the US Postal Service to have fewer privileges than it currently enjoys.

An illustrative example compares the cost of shipping to Europe and the cost of shipping within the US a 3 1/2 kilo package containing a shirt bought in New York and having a value of US\$100. If delivered to Anchorage, Alaska, the UPS transportation costs, including insurance, are \$31.50. The rate to Paris, including brokerage fees and insurance, is \$77.50 to which are added 13 per cent customs duty, 20 per cent VAT, in addition to the customs duty and VAT charged in transportation costs. The door-to-door shipping cost to the consumer is \$93 from New York to Paris, compared with \$31.50 from New York to Anchorage. The total cost of this purchase, including transport, is \$139.75 in Anchorage, and \$227.58 in Paris. The shipping distances are roughly equivalent and Anchorage is less densely populated than Paris. If the \$90 differential for shipment costs could be reduced, global trade would be promoted enormously.

### *Discussion*

**The ministry of Posts and Telecommunications, Japan** disputed whether the 10 per cent share held by post offices actually does make it difficult for the private sector to compete by reducing prices.

**United Parcel Service** clarified that the presentation cited international market share figures, not domestic market share figures; ten per cent is the post offices' market share of the cross-border traffic. As an example of a private operator's disadvantage, consider delivery of a parcel from the US to France. The linehaul between the US and Europe is a relatively small portion of the total cost. It is in the final lap of the delivery within France, where integrators have about two per cent share, that they are faced with a diseconomy of scale. In countries such as France, Japan, and Italy, final delivery is the greatest part of costs and this is where integrators lack volume, having only about one to three per cent market share. In this part of the market, post offices are dominant.

**The ministry of Posts and Telecommunications, Japan** disagreed with the UPS presentation, noting that not all post offices have the 50 per cent market share enjoyed by Germany's Deutsche Post. For example, with a 20 per cent share, the Japanese Post Office is not dominant.

**Parcelforce International, UK** pointed out some characteristics of cross-border parcels traffic. Parcels are cubic objects which do not fit in letter sorting machines. The main companies in this market are DHL, TNT, Federal Express, UPS and Nippon Express (there are no post offices). The largest companies account for about 80 per cent of the market which has a total size of about 7-8 billion SDR per year. Contrary to consumers interests, this is a highly concentrated market. It is an oligopoly of private companies (though some are wholly or partly state owned). Discussion should focus on these companies rather than on post offices, and on the real issues of cost: customs clearance, restricted air markets, delivery costs. The aim of discussions should be to advance consumer interests. The discussion of letter monopolies is not relevant.

**Federal Express** stated that the issue is not simply about competition, but about competition and regulation. Federal Express has historically favoured and benefited from deregulation. It was a prime mover, in 1976, in the deregulation of aviation in the US and, in the last two years, in the deregulation of US intrastate trucking. Federal Express does not believe that regulators should be part of the market's competition. The cross-border parcels market is a concentrated market with a small number of participants, but that reflects the expense of offering a global network. For example, like UPS, Federal Express has many employees, about 120 000 to 130 000 world-wide. Both companies have large fleets of aircraft and trucks, as well as sophisticated sorting equipment to handle parcels of almost any size. The market cannot be entered on a global scale with a small amount of capital and small operations. Federal Express has provided consumers with prices that over the last 20 years have decreased by 75 per cent in real terms. The US Postal Service has not offered anywhere near the same reduction. Though the market has few participants, these private companies compete aggressively among themselves and would like to see the post offices participate in the market subject to the same competitive conditions.

**The Italian Competition Authority** is preparing a report on how to introduce more competition in the market for postal services in Italy. Traditionally, the postal administration offered a very low price but low quality service for parcel delivery. The usual time for domestic delivery of parcels was nine days. The low quality service was reflected in low demand. However, since the end of the 1970s, demand has increased. It became evident that there was demand for a good quality service and Italy witnessed a rapid development of the private market. The volume of business of private operators is now 100 million shipments per year; total turnover by private operators is 1 000 billion lire per year for domestic services and 1 000 billion lire for cross-border services. High quality service is now available for consumers. The Post Office reacted to these developments by establishing, in 1995, two new branches to supply high quality services in competition with private operators. To recap, Italy had low-price, low-quality services provided by the postal administration and high-price, high-quality services provided by private operators. Now, competition between the Post Office and private operators in the supply of high-quality service is starting. From a competition point of view, the process must be monitored, but from the consumers' standpoint it certainly is good.

**PTT Post, subsidiary of KPN, Holland** remarked on the bid of KPN for TNT. Cross-subsidisation from the public post operator into the private field cannot occur, because Dutch law establishes strict financial separation between those operations of KPN performed under universal service and all other activities of KPN. Cross-subsidisation is forbidden. The state monitors compliance and to that end KPN must supply annual financial statements demonstrating financial separation.

KPN is not a state corporation: the Dutch State holds only a minority of its shares. Additionally, in the Dutch market for parcels, PTT Post does not have a majority share. There are many private competitors distributing parcels which offer lower prices than the Dutch PTT Post. In cross-border parcels expedited from the Netherlands, PTT Post has only a very small part of the market.

PTT Post does not currently see much synergy between the distribution of letters and the distribution of parcels, and this will further diminish because of service levels demanded by the parcel market. Service levels for parcels, such as tracking, tracing, and other value-added service, have little in common with letter distribution. These are two clearly separated markets.

**The European Mail Order Traders' Association** includes members from 16 European countries. Total members' turnover is about 40 billion Euro (approximately US\$ 50 billion) for shipments of about 500 million packages a year. An average order is about US\$ 100. There is a significant concern in Italy regarding the postal service and its effect on the mail order market. Any progress in quality of service in Italy, whether by the post or by private carriers, is welcome. The association does not address a global market and thus cannot compare the US and European situations. Though perhaps costly, it is easier today to order remotely by mail from the US with shipment to Europe, than it is to order within Europe. It is only a slight exaggeration to say that, for consumers in Europe, a single market does not exist; less than three per cent of orders today are cross-border. This situation deserves examination. Mail order companies wanting to enter specific markets tend to establish an affiliate based in that country because from the consumer side many barriers to trade exist. For example, a German study found that costs of delivery and regulations are major disincentives. There are also fiscal barriers within Europe such as differing VAT, legal barriers, administrative differences, financial barriers, and the cost of money transfer. Much remains to be done regarding post offices; there is not enough real competition and the developments of the European dossier on postal services is not advancing sufficiently in the direction of liberalisation.

**IAIEC/D'Arcy, Smyth & Associates** proposed a market definition derived from discussions with Ireland's regulator. In cross-border business-to-business traffic, with allowances for arrangements of post offices with integrators to do linehauling, the industry may have a 80-90 per cent share. For national business-to-business, the split is closer to equal and in Ireland there may be a 60-40 split. Regarding cross-border business-to-consumer traffic, the share in Ireland appears to be higher than the average: 70 per cent post office, 30 per cent private carriers. This is due to companies such as Dell and Gateway 2000 which use Ireland as a home base to deliver computers to consumers across Europe. Though actual figures may vary elsewhere, these statistics are significant. That is because the infrastructure needed to deliver to every household in a member state is of an entirely different scale compared with the infrastructure required to deliver to every business. This is why there is the debate over the postal monopoly, over access to post office infrastructure, and over the role of PTTs existing infrastructure in supporting global commerce by home deliveries. That is the context of post office and the regulation issues. Mr. van der Lande correctly stated that there are linkages between the problems that the integrators have with post offices limiting competition and the development of international delivery to consumers in their homes. Thus, to limit the discussion to existing percentages is unrealistic.

**The International Chamber of Commerce (ICC), France** noted the need to respect competition rules. A problem with the current discussion is that often politics and economics are mixed. The OECD study addresses the economic aspects. For both private and public operators, the business community represents a huge percentage of shipments. ICC fears that the monopolies which benefit the public operators destroy competition. Analysis should focus on issues benefiting consumers, especially the business community which, although accounting for over 70-80 per cent of the shipments, has not been closely consulted.

**Parcelforce International, UK** returned to the issue of market definition. The market is both business-to-business as well as the smaller business-to-consumer segment. Cross-border selling to consumers is limited and it is important to consider what prevents such sales. It is unclear that actual parcel delivery costs are a prime inhibitor. The ability to deliver to every address is not limited to post offices. In France, Parcelforce does not use the post office but rather delivers using an independent operator at a price half that which the post office would charge. In Italy, they do not use the post office; they deliver to every address; and 20 per cent of their traffic is to households. This demonstrates that in the developed world there is sound infrastructure, mostly privately owned, with the capability of fulfilling the consumer needs. The issue remains as to why cross-border sales of consumer goods have been so underdeveloped. It does not appear related to market structure in terms of operators. It must stem from customs regulations, administrative procedures, differential tax rates, cultural perceptions, and perhaps the enterprises operating in the mail order industry which faced with large local markets, may not yet have focused on developing an international presence. These issues are worth examination and, except for customs and transport costs, have not been dealt with in the papers.

**Deutsche Post AG** commented that delivery is a major cost factor. In a way, integrators are not eager to enter the business-to-consumer segment in Europe because private household stops cost far more than business-to-business delivery. Thus, integrators focus their systems on business-to-business traffic. They do not have the scale economies in their respective European markets to deliver to private households and are therefore not keen to enter the business-to-consumer market. Consider the US market where domestic and international revenues together constitute a 50 billion DM market and the top five players account for over 85 per cent of volume. UPS has over 50 per cent market share of the international parcel market and so can also easily do private household deliveries. They do so in the US but, even with a 50 per cent share in the parcel market, they add a surcharge to cover additional costs for deliveries to private households. In Europe, all domestic revenue, together with the international, make up a 45 billion DM market, roughly equal in size to that of the US. But the top five players, which are private companies as well as postal administrations, account for about 20-25 per cent of the market. Deutsche Post expects that in the future there will be a concentration of market share in Europe, and that the delivery costs will thus go down dramatically. An example from the Dutch and the Belgian market is a private operator called Selectra which does deliveries to private households offering attractive prices. There is an entirely different delivery system than that used by the integrators. The concentration of market share in Europe will resemble the evolution that has taken place in the US market. Delivery costs will be driven down significantly, benefiting customers.

**US Postal Service** felt the review should have a narrow focus, taking a close look at parcels and the consumer. The US Postal Service is moving aggressively in the direct mail market, working with US businesses that are interested in working with postal administrations. The Post Office is doing this in a fair, transparent manner and the ultimate beneficiaries will be consumers. Critics charge that there is a degree of cross-subsidy from first-class to parcels. However, the Postal Rate Commission ensures there is no cross-subsidy. When the US Congress returns in January 1997, new legislation mentioned earlier will be introduced. This legislation will not give the postal service a free ride, particularly not with respect to First Class mail. The postal service will not be permitted to raise rates arbitrarily. Rather, it will be able to raise rates for non-competitive, i.e. monopoly services, annually up to an inflation factor. These rates will be subject to scrutiny by the Postal Rate Commission.

**The UK Delegate** noted that parcel delivery is perhaps not the dominant factor inhibiting the growth of the global marketplace. There are many factors, only one of which is the focus of this meeting. There are at least three issues affecting cost. One is the economics of the parcel business. A second is regulatory barriers in a very wide sense, for example, issues of customs procedures. The third is the extent of competition, including the issue of cross-subsidy.

With regard to costs, it is debatable whether economies of scope exist in this market, in particular, whether there is a significant benefit to handling letters and parcels in the same system. An issue is whether there are economies of scale, in, for example, the long haul business or in the local delivery business. It would appear that there are economies of scale in local delivery, even in delivery exclusively of parcels. In any one market, only a limited number of operators can attain those economies of scale. There is another question regarding the economies of transferring mail, in particular parcels, between operators. This is relevant since if there are economies of scale, there are two possible models for business. In one, a single company picks up mail, for example in the US, and delivers it to a household in Germany. The implication is that there must be a very limited number of participants in Germany, big enough to do so economically. There may be global operators that will be big in every market. In the other model, an operator with economies of scale in one market picks up mail, perhaps passes it to an integrator with economies of scale in long-haul and then passes it to another operator with economies of scale in the local market. In this case, there are different operators in the individual markets with no disbenefit to consumers if the costs of interchange are small. As this indicates, information on not only individual cost elements but also on the costs of interchange would be very helpful.

**The Canadian Delegate** commented that the discussion has explained the particulars of parcel delivery but has not yet elucidated the impediments to international parcel delivery for consumers. Among other topics, regulatory barriers, cultural issues, and local practices have been discussed. It would be useful to address to what extent, what element of the cost is captured by these impediments, and whether, if some of these impediments were eliminated, international parcel delivery would be facilitated. The discussion of post offices and of private carriers is interesting but perhaps not essential, except if elements of cost-competition issues impinge on international parcel delivery, if post offices engage in practices considered to be less than pro-competitive. The discussion should focus on what the impediments are, how to facilitate international transactions and whether impediments stem from the structure or nature of the industry or stem from regulation.

**The Organisation of Postal Consumers, US** noted that cross-subsidy, an issue of critical interest to consumers, does, in fact, occur in the US.

**The Ministry of Posts and Telecommunications, Japan** stressed that the discussion in CCP should concentrate on cost factors specifically tied to the improvement of international parcel delivery services, and should not be expanded to include the general issue of postal service.

**The Federation of European Direct Marketing** noted that the forms of the delivery of the goods and services are what is important. The post is an essential part of the global market. Although discussions often say they are about a global market, they are in reality about national markets. The ideal of the global market is lost as talk reverts to the familiar, which is national markets.

**International Express Carriers Conference** Often, discussions neglect the difference between an integrator acting globally and national post offices trying to recreate, or synthesise the same kind of activity. The truth is that the global market requires a global attitude. Moving goods across the world and managing the total operation from origin to destination by an integrated system definitely gives advantages. The job is performed better than by a national post office going to an integrator and next to another post office. Putting together functional interfaces is enormously difficult, and the difficulty is increased by regulatory barriers. Private express carriers are trying to enhance service globally. Competition rules should oblige national post offices to co-operate together so as to recreate a service similar to that offered by private carriers. This is not happening. Instead the post offices, spurred on by union influences, guard their artificial competitive advantages. The post offices are trying to block

competition from their fragmented positions within the global market. The regulatory background is something which should be tackled. This is an area where both the post offices and the integrators have a common interest. For example: Why should an internationally integrated transaction have two customs officers? That is an issue of interest to the consumer.

**The Secretariat** commented that a focus of the Consumer Committee is whether consumers will be able to shop as easily across borders as they can in some large, deregulated domestic markets. There is a wide variety of practical obstacles, such as customs clearance. Another focus of the Committee is cost and the issue of why international parcel delivery is so expensive. As long as delivery prices remain high, the number of transactions will be limited. The pertinence of economies of scale and scope require examination. Customs clearance may also shed some light on costs.

Unfortunately, projections of potential volume are unavailable. The example of the US, where direct marketing has become an enormously important distribution channel for consumer goods, raises the question whether this serves as a template for the rest of the world. The US model has developed despite a government postal corporation that has some monopoly areas of service. Inexpensive parcel delivery in the US has permitted enormous growth in direct marketing. Can one eventually expect a similar level of distance selling in other countries and across borders? The US, with its enormous direct marketing growth and inexpensive parcel service, provides a model to be studied.

Canada provides an interesting model for simplifying customs and administrative procedures across border. This should also be explored.

**The Direct Marketing Association, US** noted that particular characteristics should be considered when using the US market as an example for future international parcel delivery demands. A key to expanding parcel delivery in the US has been the ability of direct marketers in the business-to-consumer market to use target lists, market lists and compilations to target the advertisements and messages sent to consumers. Europe has regulations which diminish the ability of direct marketers to target advertisements and to gather information on consumers. Without the ability to reach the consumer, demand is diminished. Europe imposes significant regulatory restrictions to contacting the customer. Until these barriers are dropped, there will not be the increase in direct marketing and the concomitant increase in parcel demand such as has occurred in the US.

**German Courier and Express Association:** Costs of international parcel delivery will only come down if competition increases, but post offices act in a way that destroys and distorts competition. Not only economies of scale are important, but also innovation and competition that holds down cost. In Germany, as elsewhere in Europe, there are small companies which successfully join to form international parcel delivery services. In Germany, the post destroys the competition by offering dumping prices and tie-in agreements with suppliers of the post. The post is sufficiently strong that they can force their suppliers to use the post only. For example, if Mercedes Benz, which sells over 9 000 trucks per year to the post, used another mail company, they would lose their business with the post. There are thousands of other suppliers to the post that have to act in the same way as shown by letters from the post to the suppliers. Thus, the market is actually being destroyed. This still does not prevent the Post's parcel market sales from declining to 3.5 billion DM last year from 4 billion DM the year before. All private competitors are being affected in the same way. Prices are declining, competitors are leaving the market. If this continues, there will be less parcel delivery in the future and that is dangerous for the entire market. The solution is for the strong monopoly of the mail and the parcel service to be separated. They should be separate companies run independently from each other. The post office's parcel post would then be on an equal footing with its competitors.

## Session II

### **DEUTSCHE POST AG: SPECIFIC COST FACTORS IN INTERNATIONAL PARCEL DELIVERY**

Customs clearance is the major cost driver for international parcel delivery. In the intra-EC markets, utilisation of existing infrastructure by building a sufficient density is the most important factor reducing costs of parcel operators. Supported by pan-European parcel networks, parcel delivery companies are today able to offer intra-EC tariffs which are close to domestic price levels. For large parcel volume shippers, consolidated customs clearance can reduce shipping costs to non-EC countries significantly. Shipping companies have to focus increasingly on global service solutions for customers, rather than focusing on international transport management only.

Consider the cost components of international shipping for physical transportation of a parcel from origin country to destination country: there is pick-up, domestic linehaul, sorting and export preparation on the originating side. There is inter-country linehaul. There is customs clearance, sorting domestic linehaul and parcel delivery on the destination side. Consider what percentages of total costs apply to these steps. For shipping intra-Europe (such as from an EEC country to Poland or Switzerland) for base parcels (not express), using mostly ground trucks, originating country pick-up accounts for about three to five per cent of total cost. Originating country domestic linehaul, sorting and export preparation accounts for another four to five per cent. Inter-country linehaul, mostly ground truck, is about four to five per cent. The major portion of total cost, about 70 per cent, is customs clearance. Destination country domestic linehaul accounts for four per cent and final delivery is 15 per cent.

Regarding shipping from Europe to world-wide destinations like Asia or the US, pick-up decreases to two per cent, domestic sorting to three per cent, inter-country linehaul (mostly air express) is about 30 per cent. Customs clearance goes down to 50 per cent. Destination country sorting domestic linehaul and is three per cent and delivery is ten per cent. The key factor remains customs clearance.

A problem with customs clearance is that it lacks economies of scale. There may be slight scale economies, but overall customs clearance cost is fixed. That is not true for the other cost components: pick up, sort and linehaul and delivery. These are based on utilisation of existing infrastructure.

Customs clearance is the major cost on which to focus. Consider how parcel delivery has developed in intra-EC markets where there is no customs clearance. In these markets, there is only the pick-up, the domestic linehaul, sorting, export preparation, inter-country linehaul, domestic linehaul and delivery. For the base, the surface networks, probably 10-12 per cent is attributed to pick-up, 15 per cent to domestic linehaul and sorting, 10-15 per cent to inter-country linehaul. At the destination, domestic linehaul and sorting is 15 per cent and delivery is 40-45 per cent. These are industry averages for domestic delivery.

Thus, in the intra-EC markets, reduction of delivery costs is the main task for shipping companies. To fulfil that task, parcel delivery companies have developed different strategies to build up pan-European networks with a focus on cost reduction, either by an acquisition or building up company operations in the destination country. A blend of these two strategies has been followed by UPS, which has built up operations across Europe often via acquisitions or, as in the case of Germany, built up its own operations. A third possible strategy is to find franchise partners, medium or large size companies in the destination country. That strategy is being executed, for example, by DPP or German Parcels. There is also the possibility to co-operate, which is the preferred strategy of postal administrations. Post offices co-

operate with each other or work with private delivery companies in various markets. The execution of these strategies will effect how successfully a parcel delivery company can reduce parcel delivery costs in various markets.

There is a clear trend supporting the development of a pan-European domestic market. Customers today no longer think in terms of national markets, they think intra-EC. European logistics provides an example. Traditionally, full warehouses were kept in most countries. These warehouses could fill orders with one day delivery time within their domestic markets. Today, the best practice is to have a Euro-centre warehouse with national partial inventory warehouses. In the future, operations will be possible from one single Euro-centre warehouse which will cover the whole EC market. That will also be true for mail order companies.

The result is pan-European coverage with equal service quality and competitiveness of the parcel delivery companies. Customers installing Euro-centre warehouses, will require that the parcel delivery companies enable shipment out with the same time in transit. That is a clear logistical trend in Europe, and significantly, this has caused a dramatic reduction of prices in the intra-EC parcel delivery market. For example, in 1992 it cost 50 DM to send a 5kg parcel sent from Germany to Benelux. Today the rate for a 5kg parcel is between 8.50 and 10 DM which is very close to the German domestic market rate.

For shipping to non-European countries, customs clearance per parcel accounts for at least 50 per cent of the total cost. Parcel operators have been creative in finding ways to reduce this ratio. One solution, is to use consolidated customs clearance for large volume shippers. Doing so can significantly reduce costs per parcel.

The aim is to bring customer solutions. Consider a mail order company which wants to find a way to enter the Russian market. It can enter on its own and have a total control, be close to its customers and build up country specific know-how. The down-side is that it has to invest, has high fixed costs to carry, has to deal with foreign law and setting up such an operation is time-consuming. The other possibility is to buy the solution which has the benefits of low risk, maximisation of variable cost, lower commitment and lower switching cost. But monitoring of the quality is difficult which is the down-side of buying the solution. A real example is German mail order companies, that may want to find a market entry into Russia. They know the marketplace has more than 200 million inhabitants and they perceive it as unstable, unsafe. They don't really know how to deal with Russia, Russia is not very transparent and, especially for the shipping industry, there are many things of which to be wary : the Mafia, a high degree of uncertainty. Many factors prevent mail order companies from entering the Russian market by setting up a warehouse and a mail house. A quick entry into the market is instead sought. An entry based on a low risk strategy and with low investment. What can a supplier who not simply thinks of managing of transport can bring to that customer. There is the example of Deutsche Post which does direct marketing support.

To conclude, shipping companies have to think about problem solving for their customers and that is not only to transport a parcel from A to B. They have to offer service solutions. The customer must be approached and asked what he needs. Then a total customised solution must be developed for this customer that will ensure a stable position with his customers. In serving the customer, costs must be reduced substantially on the customer side. In order to serve the global market, this is where parcel delivery service has to increasingly focus.

## *Discussion*

**BEUC** raised two questions. One asked about the relative importance of residential customers and industrial customers in Deutsche Post's parcel delivery. The second question asked to what degree cost reductions from consolidated customs clearance would affect the residential market.

**Deutsche Post AG** replied to the first question that it is concentrating on both residential and business markets. The consignment service carries more than 1 million parcels. That is now only five per cent of the total but is increasing rapidly. Regarding customs cost for residential deliveries, the consignment service offered to households taking advantage of tax-free amounts varies by country. Some have a tax-free allowance of \$200. Most have an allowance of around \$100, which is significant enough for most mail orders so that no taxes are paid by the consignee.

**German Courier and Express Association** questioned subsidisation of this consignment service by the German Post. A government study, by the German Cartel Office, showed that the German parcel service, which has annual sales of 3.5 billion and a loss of 2 billion, received a subsidy of 2 billion marks annually, *i.e.* every parcel is subsidised 50 per cent. Does that also apply to the consignment service? There is the question whether trade is distorted if mail order parcels are subsidised in a way that bars private companies from entering the market. A further question is whether it is helpful to develop such services for the mail order business in order to keep out other companies. That may limit rather than develop the market.

**Deutsche Post AG:** The consignment service is not only limited to direct marketers or mail order companies. The service is also offered to, among other sectors, the business-to-business market. The service is available and attractive for all industry, regardless of size. International parcels are treated totally separately. There is no cross-subsidisation to keep the rates low for mail order companies for that service. Rather, the German post has simply figured out an intelligent way of operating, which gives the customer good value for money.. For instance, 50 per cent of cost is customs clearance. By making a consolidated customs clearance, costs can be reduced; rather than paying 20-30 Dmarks for a parcel, it can be reduced to 20 cents which represents a considerable cost saving. Also, bilateral negotiations are underway with post operators as well as private operators and they simply gave us a market quote that they are going to require in order to deliver the packages.

**US Delegate:** The key question is why, for the same distance, the costs are so different for international and domestic parcel delivery. The figures show that international cost is two to three times domestic cost. According to Mr. Pusch, customs clearance accounts for 50-70 per cent of the cost of an international shipment. If true, that would account for international delivery being two or three times the domestic cost. The veracity and source of those figures is thus highly important.

**Deutsche Post AG** stated that although the figures were not derived from a precise study, broad experience and knowledge gave the ratios credibility. While there could indeed be exceptions, by observing the market trends in inter-EC markets, it is clear that the figures referred to are applicable. In fact, the market rates for inter-EC parcel shipment especially between neighbouring countries, such as Germany to Benelux, is already close to the domestic market level. This is because there is no customs clearance and because pan-European networks are being developed. For example, UPS has a good infrastructure in Germany and can deliver there at low cost. But because their network is not as developed in Benelux, the same costs are not achievable there. That is the only reason for the difference between the rate to ship domestically in Germany or to ship to Benelux. But the trend indicates that scale economies will soon apply in the Benelux market for UPS and prices will then be only distance based. The price of

shipping a parcel from Dusseldorf to Munich will then probably be higher than the price of shipping a parcel from Aachen to Brussels, because the latter distance is shorter. This is how pricing will develop in the EC market.

**International Express Carriers Conference.** The difference relating to consolidation, as illustrated for UPS, appears considerable. Can any participant do consolidation based on a factor such as volume, or is consolidation restricted to post offices? If it is only available to post offices, why is this?

The discussion has focused on customs clearance, *i.e.* a cost occurring at the point of import. But air transport involves another set of costs, security costs. These arise at the point of export and can be considerable. Security costs are applied in a somewhat insensitive manner; they are not always adjusted to risk. While risk assessment techniques are well advanced by customs, they are less well understood by security authorities. Is there significant cost for security which results from post offices using air transport?

The discussion has centred on customs costs. But to the consumer quality of the service, reliability and rapidity are equally important. One problem with customs and official controls on international movement is their delay factor. This is acute in circumstances tied to security, but it is also becoming an issue because of drugs and money-laundering. Post offices will have to meet these legitimate risk assessment requirements of control agencies, and it confronts them with an interesting challenge. But the risk assessment basis in terms of delivery will be differentiated, depending upon the ability of the carrier and the agency responsible for the transaction to satisfy the control authorities, showing that risk assessment techniques have been properly applied. This will be tied to origin, destination, data flow, tracing and tracking. Thus, customs costs does not address overall roll of the customs intervention, but only one of its aspects. The other aspect of delivery, quality, will be highly important in the future.

**Deutsche Post AG** responded that consolidated customs clearance is a common practice in the freight forwarding industry. The reason parcel delivery carriers use it infrequently is that generally it is not a matter of one customer, but rather ten thousand customers, sending shipments to various consignees in the destination country. So customs clearance must be dealt with on an individual basis; for a consolidated customs clearance there would have to be one importer who also funds the money to tax authority, and that must be split up again to the ten thousand shippers. For that reason, this is not common in the parcel industry, although there are no prohibitions. Post is not treated differently than other freight forwarders or parcel delivery companies. The reason is that for parcel delivery, there are thousands of customers shipping just one or two packages. To provide consolidated customs clearance for all of these shipments is not fruitful. Your second question concerns the security cost factors for air transport. We don't have more costs in that respect than any other operators. In the German Post we have a joint venture with Lufthansa and with Frankfurt Air Cargo handling company, so from the security point of view there is no other costs involved than for any private operators.

**Sweden Post International** noted that the papers presented for this meeting included an account of the Canadian system for clearing parcels through customs in a sort of collective way. As Mr. Pusch mentioned, this is a common practice, at least in northern Europe. This deserves closer examination as it appears that the Canadian system is more complicated. Sweden Post has, for many years, operated a collective customs clearance system. It is a commercially successful service. The only problem is that it is a concept that can be copied by anyone. The situation today is that some public operators have been clever enough to realise that this is a good product to market, but unfortunately others can do the same thing; there are no exclusive rights in it. In light of this, a further study should be made into the European consignment service.

As the Chairman of European Parcels Task Force, Mr. Pusch should have very good knowledge of the situation in Europe. Sweden Post International's assessment of the central warehousing situation differs a little, as they have seen a concentration of stocks to central Europe. But their current impression is that this trend is reversing because of the traffic situation in Europe. Roads tend to be clogged by trucks and theoretical transit times are not the same as real ones. There is also the problem of airports. One sees consolidators today looking for new locations where they can land and operate during night time. The Swedish impression is that the tide is turning back to having a central stock somewhere in Europe but also rather extensive stocks in regions of Europe. They view this positively because centralisation of stocks creates a lot of parcel traffic both for the public postal operators and for private companies.

**Federal Express** explained how the Canadian program operates both from the point of view of Canadian Government and from both sellers and shippers into Canada. Federal Express has been involved in the Canadian Low Value Shipment Program for about three years and finds the program has worked very successfully. Canadian customs officials have also commented on their satisfaction with the program and have expanded it by raising the Low Value ceiling. Customs feels comfortable that they have maintained security, receive the information required, and generate appropriate revenue without creating unnecessary costs. The program provides for those carriers, companies and shippers able to provide the Electronic Data Interchange (EDI) interface for customs clearance, to transmit a cargo manifest or cargo release list from origin to the Canadian destination. On receipt of the cargo release list, Canadian customs can peruse it and identify shipments for examination. According to Canadian Customs, two to three per cent, and rarely more than about five per cent, of these shipments are examined upon arrival. What that means for a company like Federal Express is that 95 to 98 per cent of shipments are free to be released and delivered on arrival in Canada. That represents a great improvement in productivity for shipments in this 'Low Value' category. The ceiling of the Low value category was recently increased from C\$ 1200 to \$C 1600. Shipments up to C\$ 20 are duty free. The balance are subject to various duties and taxes which the carrier is required to pay.

There is another element of the system implemented by Canada which has resulted in cost savings. In the past, Fed Ex had to make daily settlement of its accounts with Canadian Customs. Now, with shipments on line, settlement is on a monthly basis. This yields large savings in carrying costs. Canadian Customs gets savings in paperwork and logging requirements. As payments are made one day per month, there is a maximum of 54 days from shipment arrival in Canada to payment of the duty on behalf of customers. That means that often, before settlement with Canadian Customs, collection is made from customers, any disputes with customers are resolved, and Federal Express has the benefit of the float from these collections. Federal Express is dealing with a fixed amount. Customers are comfortable paying customs duties owed. The system is a simplified one. Federal Express' quality has improved, and costs have gone down. Canadian Customs is also pleased.

**The Canadian Delegate** added that this program was established to cover transactions involving consumers. It is exclusively directed to residential consumers and does not cover commercial transactions. Revenue Canada, which administers the customs program, is very pleased with the way the program is working and is also getting very positive feedback from Canadian consumers.

**The Secretariat** raised a question about goods that exceed the de minimus amount of \$Can20. How are the taxes and duties on these goods collected? Is collection from the consumer on delivery or does the seller collect taxes and duties up front?

**Federal Express** mentioned that a cost borne by an importer of record is the advancement of duties. One of the driving factors in implementing this billing system was the bankruptcy of a large

number of Canadian customs brokers due to their substantial advances for duties and taxes. The customs brokers bore the cost of this float as well as losses from customers who didn't pay.

The way the current system works is that to get release of a shipment, the company that is carrying or responsible for it advances the money. Federal Express acts as its own broker into Canada. Some other companies use customs brokers. Federal Express has a bond with Revenue Canada against which draw downs are taken daily. FedEx pays Revenue Canada on a monthly basis. This float is a cost of which one must take account. One must compare what is paid out with what is received back from the customer, and also determine the level of risk to be assumed for the customer -- does one bring in a \$50,000 shipment, a \$5,000 shipment?

**The Secretariat** asked whether under this Low Value shipment program, Canadian taxes for individual consumer transactions are collected when delivery of the product is made.

**Federal Express** confirmed that this is the general principle though to some extent it depends on the nature of the recipient. Collection is made from residential customer upon delivery, although customers who have an account already will be billed. This last fact must be reckoned with. If duties on a delivery are very large, risk is very large. If this volume business is very large, the risks are very large.

**Canadian Delegate:** For this program to work, it is essential that the Canadian customer give power of attorney to the carrier or the customs brokers to cover the customs fees or the customs costs to the authority.

**Parcelforce International, UK:** The discussion is beginning to get to the heart of how international distribution actually affects the widening sale of consumer goods. Tools such as consolidation have been available to manufacturers for many years and yet the expansion of sale of consumer goods has not achieved its full potential. Customs clearance has always been a problem in that the importer of record must collect the duty from the consignee. It is regrettable that some consumers do not pay. That means that an importer bears a considerable risk from individuals. This has hindered international trade. One suspects that risk is one of the reasons why mail order sales have not expanded in the way one might expect. Post offices are large and can afford to bear this risk, which is one reason explaining why post offices have historically done much of this business. Other factors alluded to by Mr. Pusch include the need not only to collect duty but payment of the goods. Deutsche Post assumes the task, for example, of collecting payment in rubles and changing it into deutschmarks. This is a considered business judgement and it overcomes one of the barriers. There are lessons to be learned. The first is that consolidated shipments, by their nature, require high volumes. A particularly large company is needed to generate high volumes fairly quickly. That means that to develop a market, one must look to existing large companies or must develop a system of clearance of individual packages that is extremely cheap. To make it extremely cheap, the risk of duty must be shifted to the manufacturer and paid in advance. That effectively removes a lot of the risk in selling in a new market where there are customs barriers. This has been done by a system called Global Package Link. It has opened the whole world to any shipper now in the US who can send an item, duty paid, by it, anywhere. This system deserves further explanation because it has transformed the ability of companies to enter a booming market for consumer goods.

**Secretariat:** A key question is what prevents a mail order seller from collecting foreign taxes and duties up front from the consumer and putting it all on a credit card at the time of sale so that the goods travel, duty paid, taxes paid, to the recipient country, effectively making the border transparent?

**Canadian Delegate:** The program does apply to non-commercial transactions which mostly involve residential consumers. But this program also applies to business consumers making a purchase for less than C\$ 1600.

**United Parcel Service** commented on Mr. Pusch's estimate that customs clearance account for 50 per cent of costs. The UPS representative thinks this relatively high, the percentage is substantially lower. He also differed from Mr. Pusch's view that customs clearance costs show no significant scale economies. UPS believes there are enormous scale economies in customs clearance which are reinforced by regulatory reform. The integrators are currently making huge investments in electronic data transfer and computer systems. This is being done not only to facilitate customs clearance. These computer systems are a huge, fixed investment and with increased volume the cost per parcel cleared will come down dramatically. Certainly, there are fixed costs and there are enormous potential for gains to be made in customs clearance. If an integrated system could be developed which combines import and export procedures, that would be a major advance in reducing costs. Another simple way to reduce costs is by increasing the de minimus level which in many European countries has a maximum of 22 ECUs. If that level could be raised to the \$200 used in the US, the average cost of customs clearance would be lowered enormously.

Although traffic jams exist, they still see central warehousing in Europe as a trend. Most traffic jams are being overcome by operating overnight when there is less traffic.

### **Session III**

#### **NATIONAL ECONOMIC RESEARCH INSTITUTE (LONDON)**

#### **“THE RELATIVE SIGNIFICANCE OF SCALE ECONOMIES AND ECONOMIES OF SCOPE”**

##### **Associates**

This session focuses on scale and scope economies in the provision of mail services, the implications for regulatory reform and the need to stimulate growth in the market. Studies to date have concentrated on letter services, national letter services and residually on national parcel services. Unfortunately, information is lacking concerning scale economies and customs clearance.

Scale economies refers to the situation where average cost declines when the scale of output increases. These economies arise if there are significant fixed costs or if, on expanding output, different ways of operating are found. This definition focuses entirely on the production side of the industry. It ignores the demand side; this is a general point about scope economies as well. Outcomes and markets may not be such as would be predicted from observing what happens in the production process. There may be significant scale economies in production but this may not result in a market with a sole operator. A reason may be that consumers do not want just a single output from a single producer, they may want a range of outputs and the market has room for a number of different operators. It is important to distinguish between scale economies realised simply by increasing volumes over a given network and economies realised by adding networks together. These need to be distinguished, for example, when one starts adding delivery points to networks.

Scope economies are familiar: in producing two outputs if some common costs are shared in their production the average cost falls. There may again be demand side effects. The term 'one-stop-shop'

has been commonly used; this says there are scope economies for consumers to reduce transaction costs by using a single supplier.

Postal service is commonly viewed as composed of four general functions. In **collection**, there are moderate scale economies: driving between collection points is a relatively fixed cost. With more volume at each collection point, average cost declines. Thus, one expects moderate scale economies for both letters and parcels. Concerning common pick up points for letters and parcels, a number of postal administrations are beginning to separate pick up points for letters and parcels which suggests there are only moderate, even limited, scope economies in collection.

In **sorting**, the scale economies come principally from the use of automated machinery and this occurs with both letters and parcels. Scope economies are limited because the machinery used for letters and parcels is quite distinct.

In **trunking**, there are scale economies from filling the van with more input. But these are moderate scale economies, since the extent of the economies depends on the size of the van or plane or train. There are some moderate scope economies because letters and parcels can be transported in the same vehicle.

**Delivery** appears to be the area with the greatest potential for economies of scale, particularly in letter delivery to households. It costs no more to push several letters, rather than one, into a mailbox. Within a market, there are different delivery systems for letters and parcels, which again suggests a limited scope economy.

To test the above hypotheses requires an enormous amount of data related to the costs of each of these activities. Data over a long period of time is needed for an analysis that looks at variations in costs in relation to all the factors, (such as the output, input, prices, technology change, regulatory change, changes in service quality) that affect cost. To do such an investigation, a great deal of work is needed as there is little data in the public domain. The US is the main place with public domain information on postal service and it is about the public postal service. There is virtually no public domain data available on the private sector. Hence, analyses done in the US and the UK have focused on the aggregate businesses and often the aggregate letter businesses. This partly reflects economists' interest as to whether the letter business is a natural monopoly, but also reflects the data available.

Though there is not universal agreement, there is a broad consensus that the letters business has scale economies and cost elasticity between 0.6 and 0.8, that is, a ten per cent volume increase raises costs six per cent to eight per cent. Results for the parcel side indicate somewhat weaker economies. The few available results which break out each postal function suggest, unsurprisingly, that the strongest economies are in delivery. Data from the US suggest that a ten per cent increase in volume will be accompanied by a three or four per cent increase in costs.

There is very little analysis of scope economies, partly because of the lack of cost data separating letters from parcels. Some work has been done looking at different letter services, priority/non-priority, and has found scope economies. But there is no real evidence of scope economies between parcels and letters. While the studies to date are not totally definitive, they do suggest two things.

First, there are economies of scale. If the business grows rapidly, average costs should go down. Data does not indicate whether the economies of scale are the size of the whole market. But this morning's figures showed that the number of operators in the international and national parcel market are numerous by network industry standards. There are some scale economies but not so pronounced as to

result in a market with a single operator. This may partly explain customer preference for diversity of suppliers.

Market liberalisation is another issue related to economies of scale and scope. Debates have often centred on loss of scale economies and possibly of scope economies versus whatever benefits are gained from liberalisation. Benefits can be considerable: new entrants may lead to service innovation; there may be pressure on costs and improvements in service quality. New entrants may, however, cause some loss in the scale economies which exist for letter services. There may be a small loss in economies between letters and parcels. The dynamic benefits which offset losses may be large, but they have not been quantified. Therefore, a strict evaluation of the pros and cons of liberalisation is not yet possible. The evidence of strong economies in delivery does raise the question of whether, to keep down postal costs, any operator with an extensive delivery network, typically the postal administration, should be obliged to provide competing operators with access to their delivery network. This would imply significant regulatory intervention but is an issue raised by the existence of scale economies.

### *Discussion*

**Sweden Post Logistics Ltd.** reviewed its experience regarding scale and scope economies. In 1989, they realised that their system delivered parcels and letters but they did not know their costs or quality. It was not known which functions lost money and which made money. A radical overhaul was undertaken. Parcel service was made a separate profit centre. They switched from integrated systems which treats letters and parcels together to dedicated production systems. Production services were purchased from sub-contractors rather than done internally. Post Logistics went to loose-loading, loading directly into vehicles rather than cages, and information systems were integrated with the production systems. Sweden Post Logistics now controls the process but sub-contracts most of the functions of the process. Pick-up and handling at the local sorting centre, delivery, handling at distributing of local sorting centres is all provided by sub-contractors. In most cases, this is Sweden Post Transport Group because it had done such services in the past and perhaps had an advantage when purchased by Post Logistics. But this may change over time. For long-distance transport, most of the operators are private companies. Post Logistics itself operates the main sorting centres and hubs, but otherwise this is sub-contracted. This has led to a rather dramatic change. In two years, Post Logistics' profit margin has increased by 38 per cent, quality has improved and they are certified according to the ISO 9001.

They have definitely found that they have economies of scale. This type of production system is impossible without substantial volume. Economies of scope have been very small. In fact, they went from an integrated system to a dedicated system which indicates that economies of scope is not the main issue.

**International Express Carriers Conference:** International, cross-frontier movement has economy of scope due to the fact that traditionally there has been bureaucratic intrusion. In the past, the customs officer, as the leading representative of the bureaucracy in international transactions, said 'bring your piece of paper, properly completed to my office between 9 and 3 o'clock in the afternoon and I will carry out my responsibilities to you to my satisfaction'. That created considerable difficulties and made certain express activities impossible. The situation is now different with reduced paperwork. The economy of scope is the ability of customs and other control agencies and post offices or private integrators to arrange their relationships with the governments so that the data required for control purposes come from the information commercial people and the post offices already have, and the time, manner and place in which data is accessed is absolutely convenient to the supplier. That could represent an enormous economy and that is the reason for concern about customs costs. One method could have

customs costs equal to 50 per cent of total cost. Using another method, these could be minimal. The interest is to try and shift from one system to the other. It should also be possible to deal with customs, dangerous goods, environmental and security controls at any time. The interface between carriers and the legitimate calls of the control agencies needs to be rationalised.

**Secretariat:** The discussion appears to say that economies of scale exist in the market to a much larger extent than there are economies of scope. That would justify the traditional argument of natural monopoly. This raises the issue of reform. The argument of natural monopoly is often used to justify the current regulation of post office systems but it seems economically possible to have several firms operating in the market for letters and freight.

**Parcelforce International, UK** suggested economy of scale be defined as a greater than proportionate increase in output for a proportionate increase in inputs over the long-run. This differs from the definition given by Phillipa Marks who described a short-run marginal cost of nearly zero leading to a very rapidly decreasing short-run average cost. Ms. Marks' definition would suggest that if economies of scale existed they would cause a natural monopoly which there would be every justification to encourage. Parcelforce's view differs. It believes that if short-run marginal costs are nearly zero, there is no economy of scale. For example, with a man and a van to deliver, the marginal cost of filling the van is zero until capacity is reached; another van is then added at precisely the same cost and the marginal cost is again zero and the average cost is reduced to the level of the first van. Economies of scale do not exist in this business, properly defined. A possible resultant policy could be that any large operation should be broken up in much the same way as AT&T was broken up because there is no advantage to large operations other than market dominance. The Parcelforce representative believes this the correct argument. The only possible counter-argument would be if there is a political imperative to even out the cost differences that may occur because of geography. That is called the universal service obligation. It is a matter for politicians, not economists. Therefore, it would be wise to concentrate on short-run average cost movements rather than economies of scale which probably cannot be measured. In the UK parcel industry the highest returns on scale are earned by the smallest operators; that does not suggest economies of scale.

**Sweden Post Logistics Ltd.:** To operate a parcel distribution system with automatic, mechanised sorting centres requires substantial volumes. Economies of scale are few in local distribution and collection but do exist in the sorting centres.

**The Secretariat** felt the lack of scale of economies in deliveries to be counter-intuitive. It would appear obviously cheaper per parcel or letter for a delivery van to drop off ten than just one. There is a minimum size needed to have some efficiencies, to have minimum efficient scale. The pertinent question is how that relates to the delivery of parcels. Some assert that the final delivery leg is an important element in the total cost; the more dense the route, the greater its efficiency. This raises the question of how one arrives at that point and also the issue of reserved services for letters. In some countries, the nature of the reserved service and the extent of the monopoly, is greater than elsewhere. At what point can parcel firms start carrying documents in the US and start picking up some economies in delivery?

**US Postal Service** challenged linking the issues of reserved services with those of international delivery of parcels. The rules governing competition view letters as tangible communications. For the most part, who can deliver letters depends upon the level of service required. US law has always said that if equivalent postage is paid anyone can carry the letter. This is a disincentive to underprice. But delivery without restriction is permitted for letters that are extremely urgent within, into or out of the US. That raises questions as to what the restrictions on letter delivery has to do with international parcels delivery. Clearly, there are economies of scale in the delivery of letters. If, as suggested, the economies of scope are limited, what does the addition of letters to parcel delivery do to economic efficiency overall? It may be

better to consider whether there economies of scale in delivery of parcels. The US Postal Services' experience, particularly with surface parcels where United Parcel Service is a dominant firm, strongly suggests that there are scale economies. UPS has been able to achieve processing efficiencies, transportation efficiencies and, by delivering more parcels to each delivery point, efficiencies in their delivery network. Economies of scope in parcel services are however limited. To the extent they exist, they must be measured against the loss of scale economies in the letter business. It is not apparent how discussion of restrictions on competition in letter mail, given the economies of scale, clarifies how to improve the delivery of international parcels for the benefit of consumers. Anyone in the international parcel business or sending international parcels to households also has to market their services. As pointed out by Mr. Cerasale, the mail is a primary marketing tool and one of the costs that goes into the cost of goods. It costs something in the delivery of parcels to reduce the efficiency of the letter market.

**Ministry of Posts and Telecommunications, Japan** Newcomers can easily enter the market by providing services only in urban areas; in other words, by skimming the cream. Facing such competition, postal operators would be hard pressed to maintain universal service, and might not be able to provide sufficient services in rural areas. This possibility should be considered.

**The Secretariat** commented that the intention is not simply to compare scale economies with scope economies. Rather, the idea, to some extent based on the German experience, is to consider a redefinition of the exclusive privilege of the post office, a redefinition which would scale back its monopoly. The public post office would lose some scale economies but there is evidence that this might lead to a general lowering of the public sector's cost curve as more competition led to more efficient organisation, and perhaps to more efficient technologies. The entire cost curve might shift down. There is the question whether in an ideal world, there might be lost economies of scale for the post office, but which coupled with a reduced cost curve might have a neutral effect and at the same time lift economies of scope. Would there be economies for private sector firms able to deliver parcels and letters at the same time? Would such joint production produce economies with a result of decreasing price levels in the parcel market?

**The Secretariat** expressed interest whether, across countries, the nature of the reserved service is different and whether that leads to different effects in the marketplace. While the discussion concerns parcel delivery, the issue of letters is related, since express couriers deliver both letters and parcels, in the same truck, on the same route. If they are entering a market with restrictions on the ability to carry documents and if there are scope economies between express documents and express parcels, then that may be why costs are high and volume relatively low in the international market.

**US Postal Service** believes this has to do primarily with the level of service provided and the organisation of the delivery company in that area. An express company, for example FedEx, is geared to deliver within a specific timeframe, basically overnight, with deferred options that allow some fill. Within that level of service, at least in the US, there is no restriction as to what they deliver. There is a price test that is the subject of debate. Basic letter service, First Class mail/ Third class mail, is an entirely different level of service and type of product from that provided by express companies and that is where there are restrictions on competition. The current price test is that a sender is presumed to be sending an extremely urgent letter if they pay at least \$3 or twice the applicable First Class postage. That is, if to send a letter by regular mail costs \$2, the minimum charge to send it by express would be \$4.

**IAIEC/D'Arcy, Smyth & Associates** returned to the question as to whether the best model is end-to-end service with high level of management control or the agency-related model with a series of contractual agreements between parties that each perform part of the service. Experience suggests that integrators are at the dynamic end of the market because door-to-door service is what the market wanted.

Intuitively this approach might appear more effective. But the market so far has been the business-to-business market. To now develop the business-to-consumer market raises another series of issues, such as overcoming regulatory interventions on crossing frontiers. There are the organisational dimensions of the operation: international linehaul means buying aircraft and setting up hubs and spokes. The US as a model has large distances combined with economic scale and sophistication, but which differs from the international market where goods must overcome regulatory hurdles which add cost. As Mr. Raven said, overcoming hurdles should be a joint venture between the carriers and the regulatory authorities. These barriers came originally from national, protectionist positions.

**French Postal Regulator:** In France there is a letter monopoly, but parcel services are completely open to competition. International companies can freely deliver parcels on French territory provided that they respect the customs and transport regulations. France is committed to maintaining an economically viable postal public service. The monopoly gives the post office the ability to finance its public service obligations over the entire territory. As the Japanese delegate remarked, to liberalise completely the postal services would mean in fact that there would be a cream-skimming of the market. This could be very beneficial to firms and to people who live in the cities. But the isolated rural areas would be left out because nobody would be interested in providing them with postal services. In the EU countries there is a draft directive which forecasts liberalising the postal services but in a progressive and controlled manner. One cannot let the market forces alone decide how the postal service operates when there are certain obligations to service the whole territory. This would not be taken into account if profit was the only motivation.

**Chairman:** It is useful to look at what is going on in the EU regarding the discussion between public services and postal areas, privatisation and deregulation. A proposal from the Commission is before the Council of Ministers and is being negotiated. There are important implications in that proposal which illustrate that trying to find solutions for consumers is not a question of black and white. There has to be a compromise regarding political interests involved, the ongoing role of monopolies and the political interest of deregulation in the context of a global economy.

**Federal Express:** In the US regulations are more complex than it might first appear. There are two parts to the rules. One deals with maintaining private competitors prices above the postal services prices. That is the price test on which Mr. Alvis reported. If a product is priced at \$2.99 or less than twice the postage, then there is a much more subjective test that is involved. This is the centre of some debate in the US. In fact, in Congressman McHugh's Bill, he decided to ignore the subjective test, lower the amount and make it a flat \$2 rule. The problem with the rule at present is that there is no upper limit. If a 20 kilo package is filled with documents and addressed to a particular person, then it is a letter. The GAO report cited in the US paper includes a discussion of monopolies in other countries which is helpful in showing how countries other than the US structure their monopoly. But in general there is a finite concept of a reserved system, a reserved sector of letters. Finite in that it is either limited by price, by size or a combination of the two. The US has put a floor rather than a ceiling on its definition and that may be applied across the board. This definition does affect express carriers as well as those potentially engaged in alternate delivery systems. The EU Directive and liberalisation is a complex issue that has been going on for a long time. One should refer back to the original Green Paper which discusses the monopolies within the Union, and gives a good historical background. Between the study of the Green Paper and the present draft Directive proposing much slower deregulation, political compromises were made. These were driven largely by factors of politics rather than economics.

**Sweden Post International:** The response to the Secretariat's question: about the limits and the reserved sector and monopoly in different countries is rather technical. But generally speaking, in most countries, the postal monopoly has been defined by a sort of physical definition. That is, for

example, the case in France; it was the case in Sweden before 1993. That is to say that a letter has certain physical characteristics and is covered by the monopoly. A few countries have another kind of limit. For example, the US has a limit expressed in dollars, the UK has a limit of £1. But that is rather an exception, the rule is to have a physical definition in the countries that still maintain a postal monopoly.

In discussions about scale and scope, there is a risk that if the examination is too theoretical the wrong conclusions may be reached. For instance, concerning economies of scope in delivery, analysis seemed based on the type of delivery made by the courier type firms which operate a van in which they have both parcels and letters. But that is not the way public postal operators deliver their types of goods. For example, in Paris the mailman delivering letters is not bringing parcels simply because he cannot do it! So there is a physical difference between couriers and post offices. Another difference is the product specifications. Most of courier products have to be delivered before a certain time of the day. Normally, that is not the case for the mass production delivery of normal letters. There are very large differences between those two operations. To talk about economies of scope in that respect is very theoretical.

**The Ministry of Posts and Telecommunications, Japan** pointed out that the argument presented in the Secretariat's document partially emphasises only the aspect of economic efficiency and ignores the value of maintaining universal service. It is not feasible to assert that if rural area residents are dissatisfied with the expensive tariffs charged in their area, they have the choice of moving to urban areas where the tariffs are lower.

**The UK Delegate** reiterated that the interest of the Committee is in the delivery of goods to consumers. Goods are, as noted earlier, three dimensional objects. It does appear that there are very limited economies of scope between the delivery of those and the delivery of letters which are almost two dimensional objects. Given that, it seems that many of the monopolies created to protect postal service obligations are of minimal relevance because they are either defined (typically) on the letter post only, or are defined by a financial limit that is so low that most three dimensional objects are in the competitive sector. As long as that is the case, the issue of protected areas for letters, and exactly how they are defined is not important. There is however another point to be made about the ability of the courier companies to 'cherry-pick' within the parcels area. For delivery of parcels to consumers, there are two reasons why the ability to 'cherry-pick' is limited. First, these deliveries are typically fairly low density. Most consumers, even within their own country, receive very few parcels each day. Therefore, someone delivering parcels, even in an urban area, is making deliveries at relatively spaced out intervals. It is not a high density business. Second, a service proposing to a mail order company the delivery of parcels from Britain to consumers in Italy will not be making a very attractive commercial offer if it offers to deliver to the major cities of Italy but not to consumers in rural areas. Companies wishing to be in this kind of business have to be willing to deliver to every address in the country of destination. If that is the case then 'cherry-picking' is not a great concern.

**The Italian Competition Authority** commented that the cream-skimming argument mentioned by the Japanese colleague is strictly related to the universal service obligations which, at least in European countries, are sensitive issue and must, in practice, be taken as given. However, discussion should move to what is the less anti-competitive system needed for providing and for financing universal service. In this respect, the approach taken at EU level, which maintains that a reserved area is needed in order to finance universal service, is the result of compromise. Following this approach, the focus of the debate shifts to how large must the reserved area be to finance universal service; the discussion becomes very difficult at this point. In principle, the fund approach mentioned in the background paper given by the Secretariat is an interesting alternative from a competition viewpoint. In practice, this approach is not really considered at the European level. One wonders why. One has the impression that the approach of maintaining a reserved area is more politically than economically justified, because it allows gradualism in

liberalisation. But it poses some dangers as well. In fact, maintaining a reserved area may also be used to stop the liberalisation process, or to make it very slow. Undoubtedly, this is an ambiguous approach. If a reserved area is maintained in order to finance universal service, the role of international organisations like the OECD and the European Commission becomes extremely important in ensuring that this approach is not used to stop liberalisation.

#### **Session IV**

#### **SWEDEN POST: “POLICIES FOR MORE EFFICIENT DELIVERY SERVICES”**

The discussion so far has shown that there may be sections of the papers presented which need to be further examined.

I have been asked to provide some points of view as regards possible policy options for the future which are listed in one of the documents. The paper ‘Main Issues for Discussion’ raises some questions. One is whether there are any new policy initiatives in member countries. Indeed there are. It is surprising that the papers make no reference to the policy discussion going on in Europe at the moment, either at national level or, more particularly, at EU level. The following is a short summary of the European discussions. The EU has been working since 1988 on a common EU postal legislation in keeping with the aims of the single market and to improve efficiency and quality for postal customers. A Green Paper containing the European Commission’s analysis and draft guidelines was published in 1992, but it was not until the Summer of 1995 that some firm proposals were adopted by the Commission. The proposals took the form of a proposed directive and of a draft notice dealing with the application of the legislation on fair competition to the postal market. The directive is to be adopted in common by the Council of Ministers and the Parliament. The Parliament has this Spring examined the proposed directive and suggested no less than 58 amendments of which the Commission later said it can accept 16. The Council of Ministers has thus far not been able to accept a common position, which means that at present the procedure has come to a standstill. The Commission has the right to simply withdraw the proposed directive and might consider issuing a corresponding statement based on its power in Article 90 of the Treaty to favour the development of a single market. That is what may happen if the Council of Ministers cannot agree. The draft notice has been highly criticised by the countries that do not want any liberalisation of the postal market and by the Parliament (possibly based on an internal fight between the various EU institutions and Parliament trying to assert its own power). The Commission has also the right to publish its notice but it remains to be seen if it has the courage to proceed in the face of the Parliament’s disapproval. That is the present political situation. Last Thursday, there was a meeting of the Council of Ministers which, according to press reports, agreed to try to agree at the next meeting in November; not a very substantive meeting.

The proposals from the Commission actually appear to be very modest. First, the Commission has suggested identifying a universal postal service which should exist in all EU countries and in the relations among them, both national and international. This universal service should comprise addressed letters up to 2kg and parcels up to 20kg as well as collection and delivery of mail at least five days a week. This ties into the present parcels discussion.

In addition, some services might be reserved for the universal service operator to enable him to bear the costs of universal service obligations. These reservable services should not, however, go beyond

the domestic letters up to 350g or priced more than five times the basic letter postage. Some categories of mail -- such as express courier items, parcels, printed matter and outward cross-border items -- are not reservable at all. There is a special case for inward cross-border items and direct mail publicity where the Commission has suggested that these could be kept in the reserved sector until the year 2000 but would normally not be included after that date; a checkpoint in 1998 would make a final decision. The draft directive also regulates other aspects such as: quality of service in and between member states; independent measurement of the quality; cost based prices and cost price compensation payments between postal operators; and separation of regulator and operator functions. The amendments adopted by the Parliament have the contrary aim of stopping or delaying liberalisation and of maintaining the job security of the staff of public post office operators. People tend to say okay for liberalisation but then add fine print reading 'but not in our time'. The work within the Council of Ministers seems, on the contrary, to be positioned much closer to the Commission's views, though there are still a lot of differences of opinion on the scope of the monopoly and about the timetable of liberalisation. In addition to this discussion on the European level, there are corresponding discussions going on in some countries. Finland and Sweden have already completely abolished their postal monopoly without the terrible consequences outlined for example by Japan. The most spectacular change is taking place in Germany which has already produced a licensing system to allow more operators to deliver direct mail items and has published plans to completely liberalise the market in the year 2002.

Among operators, there are very strong doubts that there are economies of scope between letters and parcels together. There are many factors which differ between the two fields.

Price regulation is not a good idea. What both the Swedish government and the Swedish operator advocate, is an open market situation with as little regulation as possible. Some basic regulation is of course required which is why Sweden also has a postal law of about four printed pages of text. That is what regulates the entire market. If governments want to ensure that citizens have access to a good postal and parcel service at affordable prices, they are entitled to arrange for such a universal service. If the public operator is good enough, it is certainly able to provide that universal service without any particular compensation for these obligations. This however requires that the public operator is able, within the limits allowed by fair competition legislation, to use price as a means of competing with operators not obliged to provide universal service. That is the way the Swedish system operates at present. There will be many developments in different countries in this area, and one cannot say how the present Swedish model will function in the long term.

Monopoly rights are an obstacle to the efficiency of the whole sector, letters and parcels. Operators enjoying such rights tend not to care much about their customers as there is no alternative service provider. With a guaranteed minimum income, operators furthermore have no incentive to rationalise operations or are afraid to do so for fear of labour unrest. For this reason, most European postal operators are over-staffed and the postal sector been singled out as functioning less efficiently than all other sectors of industry. Currently, the countries and public operators in favour of liberalisation are in a minority in Europe, but liberalisation will no doubt come. If it does not come quickly enough the market will seek to solve the problem in its own way. For example, the market may simply ignore monopoly rights. That happens in the field of remailing which is illegal in most countries yet nonetheless flourishes. Monopolies may be circumvented by using other means of communication, such as electronics based media. The area covered by the postal monopoly will automatically shrink.

All services should bear their own costs. No cross-subsidies from services still under monopoly to services in competition should occur. In Sweden, the parcel service operates as a completely separate business.

The possibility of a fund to finance universal service was recently considered by the Swedish government but has been set aside. Such a solution would raise the barrier to entering the postal market. New small companies are often in a weak financial position and would be unable to pay the contribution to such a fund. The fund would also probably have to be regarded as a state tax, not a popular move and one which furthermore requires a special type of legislation.

The suggestion to create private ownership of the present public postal operators highlights one of the main obstacles to rationalisation of the postal public sector, the special public service status of most employees makes it difficult for public operators to adapt to changing market situations. The problem is not ownership. Sweden Post has been, since 1994, a government-owned limited liability company. It has its own labour contracts with staff; the concept of the civil servant was abolished in Sweden several decades ago. Bringing private co-owners into Sweden Post would not make a significant difference. Sweden Post is already monitored by its owner and has internal monitoring systems on profitability, on customer satisfaction and satisfied personnel. These would not change with a private owner.

Competition must be subject to equal conditions. This applies, in particular, to VAT. Sweden applies VAT to postal prices as does Finland. The problem is that an outdated EU directive on VAT exempts postal services. When the monopoly was lifted in Sweden and Finland, the European Commission agreed with the Swedish government that it would be impossible to treat different operators in an open market differently. VAT is presently under study by the Commission. It appears that the Commission hesitates because some of the major EU countries dislike the idea. But as the whole VAT system within the EU is under revision and the postal element needs to be handled in that connection.

A participant earlier said that remailing is good for competition and beneficial to customers. But the financial basis for remailing is that the internal accounting systems between public operators are not precise, not good enough. This allows remail operators to find the cheap back doors into the public delivery systems of other countries, meaning at prices far below those paid by the domestic customer in the country of destination. This is a clear case of market distortion. This could be viewed as the result of public operators' own shortcomings, they can't get their own house in order. But such new arrangements need voluntary agreement between operators. Those who have worked in international circles know how difficult that is to achieve. Remail operators are aware of the situation and try on the political level to block the efforts of public operators to fine tune the accounting systems. However, a better system will soon develop which will reduce the unwarranted benefits of the remail operators and their customers. This will by no means mean that remail will disappear. It is a major industry today and will certainly be a major industry tomorrow. There will certainly be niches for remailers if they can offer customers better services in terms of quality or value-added services for example. To that extent, competition by remail is beneficial.

## *Discussion*

**European Mail & Express Users Association** is an association which does not just take the vested interests of the bulk mailers or those of the domestic consumer but looks after the business and domestic users in all postal and courier services. Users seek a choice of products and service levels to suit their business and social needs. But regardless of that, they seek predictability of service. Using private carriers in a competitive market place customers have a choice of products and a choice of how much value added they wish to buy, whether in terms of delivery timescale, in reporting information, or in IT support. Some postal administrations do provide a poor quality of service within their own national boundaries. Postal administrations on the whole have two weaknesses. One is that they can't control the entire end-to-end cross-border distribution chain. Thus there is no predictability for the user. Secondly,

with one or two important exceptions, postal administrations are VAT exempt. Therefore they are in effect giving a discount of the nation's VAT rate to those customers who are not VAT registered such as banks and finance houses. This is a distortion. Also postal counters, the PTT outlets, obviously do not allow competitors to sell parcel services there. As these postal outlets are more accessible to domestic customers, domestic customers are therefore being denied a reasonable choice of carrier.

**IAIEC/D'Arcy Smyth & Associates** mentioned that the EU process is, from the Irish presidency's point of view, not at a standstill. At the last meeting, each of the Council members said they still believed in a directive and were still committed to showing some flexibility. Therefore, the Irish presidency intends to ask what flexibility at the next meeting, then see whether there is a standstill. The key issues are the scope of the universal service and the timetable for liberalisation, in particular the liberalisation of direct mail and the setting of a definite deadline. The year 2001 has been discussed. The political reality is that the opposition is being led by France. Meanwhile, electronic commerce is developing which will attract consumers. If difficulties are not overcome there is a danger that international delivery services may not match up to the demand which is foreseen for consumers to order goods via electronic commerce. And if international delivery does not develop then the question is who will bear the cost. Either there will be new services charging consumers extra for overcoming the regulatory barriers, or else those who invested in electronic commerce will see their investment insufficiently rewarded, as there will not be the delivery mechanism in place to ensure fast, efficient, reliable, low cost global delivery.

**Ministry of Posts and Telecommunications, Japan** commented on the Secretariat's documents for the Roundtable saying that some conclusions had been reached without a proper examination of relevant facts. The papers compare the prices for parcel delivery charged by private companies with those charged by public suppliers. But this comparison is made between ordinary postal parcel service and private courier service without sufficient consideration given to the differences in service conditions, such as the length of delivery periods and volume discount rates. This comparison is, therefore, meaningless.

Regarding the argument concerning cross-subsidies, this does not apply to all OECD countries because such cross-subsidies do not exist in all of them (for example, in Japan, there are no such cross-subsidies). Therefore, what was pointed out in the documents cannot be said to be uniform.

With regard to the argument on the postal operator's reserved area, the arguments are made without proper understanding of the value of the universal service and the necessity of the reserved area which maintains the universal service. The documents do not recognise the harmful result of cream-skimming.

**Sweden Post International:** The idea of selling all operator services at post office counters is interesting but consider whether UPS and Federal Express would like to sell postal services as well through their sales networks. The idea does not seem to make sense. We are separate companies and we have to deal with our sales activities ourselves.

Concerning the EU Directive, there is apparently no solution on the top political level ready at the moment, but a solution might be ready by year end. In the long run, the postal monopoly will be eroded one way or another.

A few issues hamper the development of international parcel services. Exempting only postal services from VAT makes private parcel services less attractive to a consumer. Private parcel companies must add 15 per cent, whereas the post can offer the net price. That is certainly a disadvantage which makes it harder for the private company to access the private consumer market. That should be considered

when private competitors are accused of not serving the private community. The universal service obligation which has often been quoted by the representatives of post offices must not be misunderstood as saying that every and each post office must offer a counter close to every consumer. It is sufficient that the national government provides conditions giving private consumers access to adequate services whether private or postal. If that is the understanding, then obviously the government can make postal counters accessible to private competitors.

Monopoly has little to do with parcel services except for the distortions touched upon in this roundtable. The mail is still a very important factor and if the mail market is not properly developed then obviously the parcel market will suffer from it as well. That should be considered in continental Europe. The letter market is decreasing markedly for which there is no good explanation except for high costs. The lack of competition is leading to a decreasing mail market and that also affects the parcel market.

**Direct Marketing Association, US** said that in the US, which has a high penetration of computers and a very high penetration of telephones, over 50 per cent of American families each year make a purchase through direct marketing and receive a parcel delivery. These purchases are done not only by the telephone and the Internet. A significant amount is done by mail. Looking only at electronic communication omits a significant number of consumers. In the US, that would miss more than half of American consumers. That number may even be higher in other countries. Mail is a major way for direct marketers to reach current and potential customers.

**Canada Post** returned to the concept of how improving the customs activity can really change the economic activity. The Low Value customs arrangement in Canada is speeding up delivery times. If parcels are not sitting in customs, they move more quickly to the customer. That is the result originally hoped for when Revenue Canada was initially pushed to put such a system in place. Improving the customers' satisfaction with market performance will generate better economic activity in the future. The system is not just a question of cost. If production economics improve in such a way that the whole process is improved then the consumer benefits.

**The Secretariat** noted the need to continue the investigation and discussions before the Committee is prepared to draw policy conclusions. Subsequent round tables will likely be focused on specific topics. Future work will be narrower, more focused and much more in depth. The area of Customs Clearance, tax collection, the administrative paperwork tied to moving goods cross-border, is probably the most fruitful area for the next discussion.

## LIST OF PARTICIPANTS

Mr. WILLIAM ALVIS, United States Postal Service, USA

Mr. BENNY BREWITZ, Sweden Post

Mrs. G. BRUZZONE, Autorita Garante della Concorrenza e del Mercato, Italy

Mr. JESPER BUHL, Post Denmark

Mr. TIM BYE, GD Express Worldwide NV, The Netherlands

Mr. GERALD CERASALE, Direct Marketing Association, USA

Mr. M. D'ALLESSANDRO, La Poste, Belgium

Mr. MICHAEL D'ARCY, IAIEC/D'Arcy, Smyth & Associates, Ireland

Mr. BERNARD DOUSSET, La Poste, France

Mr. JEAN-MARIE DUCHEMIN, International Chamber of Commerce, France

Mr. GORDON FERGUSON, Canada Post Corporation, Canada

Mr. KURT HENDRIKSEN, DIKO/ DHL Worldwide Express, Denmark

Mr. JOHN HURLEN, Norway Post

Mr. KOUSUKE IMASHIMIZU, Ministry of International Trade and Industry, Japan

Mr. WILLIAM JOHNSTONE, United States Postal Service

Mr. HITOSHI KAJIMURA, Ministry of Posts and Telecommunications, Japan

Mr. CHRIS KALLA-BISHOP, Parcelforce, United Kingdom

Mrs. ALLISON LEVY, United States Postal Service

Mr. HANS LEIJGRAAF, Netherlands Air and Express Shippers' Council

Mrs. PHILLIPA MARKS, National Economic Research Association, United Kingdom

Mrs. MONIQUE MARSOT, GPV, France

Mrs. EUGENIA MATEOS, Ministerio de Fomento, Spain

Mr. SCOTT MCDONALD, Coalition to Make Our First Class Mail First Class, USA

Mr. COLIN MITCHELL, European Mail and Express Users Association, United Kingdom

Mr. HUBERT MORGENBRODT, Deutscher Paketdienst, Germany

Mr. JUN OKAYAMA, Ministry of Posts and Telecommunications, Japan

Mr. ANTONIO ORDONEZ, Entrega en Mano, Spain

Mr. PAUL OVERDIJK, PTT Post BV, The Netherlands

Mr. FRANCOIS PAIN, La Poste, France

Mrs. MONIKA PLUM, Wissenschaftliches Institut fuer Kommunikationsdienste, Germany

Mr. THOMAS PUSCH, Deutsche Post AG, Germany

Mr. M.S. RAMAN, Universal Postal Union, Switzerland

Mr. JOHN RAVEN, IECC, Belgium

Mr. DAVID ROBOTOM, UK Direct Marketing Association, United Kingdom

Mr. PANU SAARIKURU, Finland Post Ltd.

Mrs. KATRIN SCHWEREN, Bureau Europeen des Unions des Consommateurs, Belgium

Mr. IAN SENIOR, National Economic Research Association, United Kingdom

Mr. JONAS SKULASON, Direction Generale des Postes et Telecommunication, Iceland

Mrs. NANCY SPARKS, Federal Express, Belgium

Mr. JUNICHI TANIKAWA, Ministry of Posts and Telecommunications, Japan

Mr. ALASTAIR TEMPEST, Federation of European Direct Marketing, Belgium

Mr. FERNANDO TOLEDANO, European Commission -- DG XIII, Belgium

Mr. ANTON VAN DER LANDE, United Parcel Service, Belgium

Mr. AAD WEENING, Association Europeene de Ventas par Correspondanc, Belgium

Mr. RALF WOJTEK, BIEK, Allemagne

Mr. HIROSHI YOSHIDA, Economic Planning Agency, Japan

Mr. TORSTEN ZILLEN, Sweden Post, Sweden

## SPECIFIC COST FACTORS IN INTERNATIONAL PARCEL DELIVERY

**Dr. Winfried HORSTMANN**  
**Consultant to the Secretariat**

### **Introduction**

A common feature of markets for parcel delivery is that the rates for international shipments usually are significantly higher than the rates for comparable domestic services (OECD, 1995a, OECD 1995b)<sup>2</sup>. Costs and prices for international parcel shipments are composed of a variety of factors. The total cost for sending a parcel from one country to another basically can be analysed in accordance with three basic steps in the delivery process, namely the processing in the country of departure, the processing in the country of destination, and the processing between these two countries. According to this categorisation the following cost categories appear to be most significant:

- i)* First, costs are associated with processing the parcels in the *country of departure (A)*, where the parcels are collected, weighed, stamped, and labelled. Moreover, the items have to be sorted and transported, for example, to some airport which is the gateway to international transport and delivery.
- ii)* Second, specific *costs of international delivery* arise from international (air) transport between the country of departure (A) and the country of destination (B). If the items in question are subject to import duty, customs clearance procedures have to be applied. Furthermore, the collection of value added tax involves some administrative effort. Such procedures generate costs which add to parcel rates.
- iii )* Third, in the *country of destination (B)* the parcels are transported and sorted again. Finally, they are delivered to the local recipients. At this end of the delivery process, the cost and price situation might largely depend on whether the service includes door to door delivery or the transport of parcels to collection points.

The above mentioned pattern illustrates that the costs of international parcel delivery to a large extent are influenced by the specific conditions under which domestic postal systems operate. The regulatory situation in countries A and B does not only affect domestic parcel rates, but it also exerts an impact on the entire price for international transport and delivery. An investigation of these issues can be found in the document “Regulatory Reform for More Efficient Parcel Delivery Markets” (OECD, 1996c). The present paper, however, does not cover these issues. Instead, it is focused on the specific cost factors in international delivery as described under (ii) above.

### **Customs Clearance Procedures**

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<sup>2</sup> For more detailed information about prices for international parcel delivery see the Figures A1 and A2 in the Appendix.

An important factor which exerts an impact on international parcel rates is the cost of customs and value added tax procedures. Although the conclusion of the Uruguay Round has led to a large reduction of customs duties, various goods are still subject to import tariffs. The administrative efforts for handling customs procedures seem to have an impact on international parcel rates as well as on the speed of delivery. In this section some hypotheses on the significance of these costs are presented, which are partially based on a study carried out by the industry. After that the Revenue Canada “Low Value Shipment Program” will be discussed. Finally, some issues related to duty free thresholds will be briefly addressed.

### *The Social Cost of Customs Clearance*

The welfare effects of distortions to international trade are a subject of concern to economic and political science since more than 200 years. Both tariff as well as non-tariff barriers hinder the free exchange of goods and services, and lead to an overall reduction of economic welfare. In the case of ad-valorem import duties<sup>3</sup>, this welfare loss is associated with the magnitude of the import duty. However, the administrative costs of collecting such duties, which are at the focus of this section, lead to an additional loss of economic welfare. As can be seen from the overview over major cost categories presented in Box 1, administrative costs are generated, for example, at the firm level and passed on to the consumer. Furthermore, there are costs in terms of extended delivery periods. Finally, the public administration necessary in order to collect duties and value added taxes is costly as well.

The costs that are generated at the firm level to some extent result from the administrative paperwork that has to be done. Such proceedings make the employment of human resources as well as the use of data processing facilities necessary. Furthermore, also the final collection of duties requires some administrative effort. The Association of International Express and Courier Services (AICES), Colnbrook (UK), has requested some major UK express companies to provide an indication about the size of these costs. According to this study average costs per entry into the UK amounted to some 18 £ in 1994 (AICES, 1994, p. 2). Although the study does not explicitly provide information about the impact of tax procedures on these cost figures, one can reasonably assume that the collection of value added tax also is a significant cost factor.

An issue of particular interest is the incidence of the costs of customs procedures, which are generated at the firm level. The extent to which parcel delivery firms can pass on these costs to the final consumer basically depends on the price elasticity of demand<sup>4</sup>. If the demand for shipments reacts sufficiently strong to price changes and the market is competitive, private firms may be reluctant in passing on the cost effects of customs procedures to consumers. The possible loss of market shares associated with price increases in this case might prevent firms from passing on administrative costs to consumers. If, however, customers do not adjust the demand for shipments in accordance with delivery prices (i. e. the elasticity would take a value around zero) parcel delivery firms probably would not hesitate to transfer the administrative cost of customs clearance to consumers. Throughout this paper the

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<sup>3</sup> Ad-valorem tariffs ( $t$ ) are calculated as a percentage mark-up on the world market price ( $p_w$ ). The price a domestic consumer has to pay for an item which is imported from the world market ( $p_d$ ) then is

$p_d = p_w \cdot (1 + t)$ . By definition the inequality  $p_w < p_d$  is satisfied. For definitions of different methods of protection including tariff barriers see for example WINTERS, 1985, p. 65.

<sup>4</sup> The price elasticity of demand is defined as the percentage change of shipments, i.e. quantities ( $\Delta q/q$ ), in relation to the percentage change of the price ( $\Delta p/p$ ):  $\epsilon_{q,p} = (\Delta q/q)/(\Delta p/p)$ .

assumption is set that there is some negative price elasticity of demand<sup>5</sup>. Nevertheless, it would be useful to estimate the precise magnitude of the price elasticity.<sup>6</sup>

Additional welfare losses result from the impact customs clearance procedures exert on the delivery time. Substantial delay as a result of relatively time consuming customs clearance seems to be normal (RICHARDSON, 1996). This is to the disadvantage in particular of express delivery services which depend on speedy procedures in order to guarantee the most important characteristic of their service, which by definition is the extraordinary fast transport and delivery of parcels. In many cases express carriers may have to face extra costs that are associated with additional efforts for speeding up the delivery process in order to compensate for the time lost at the customs border.

**Box 1: Type and Incidence of Costs for Customs Clearance**

TYPE OF COSTS

ACTUAL PAYER OF COSTS

Costs associated with paperwork to be completed by parcel delivery firms. Collection of duties from recipients of parcels.

Consumers, if price elasticity of demand is low  
Parcel delivery firms if price elasticity of demand is high

Delay of delivery period as a result of time consuming clearance procedures

Consumers

Costs of resources employed by authorities in order to collect customs duties and taxes

Tax payers

The effects of customs clearance on delivery time are also of interest from the viewpoint of competition policy. There may be distortions to competition, which arise from different treatment of public and private services. The International Express Couriers Conference suspects that the relatively low rates for shipments which the United States Postal Service charges for delivery with the new International Package Consignment Service, for example from the United States to Japan are possible because of better service and lower rates of Japan Post (VITA, 1996, p. 12).

<sup>5</sup> The working-hypothesis applied here is that  $-1 < \epsilon_{qp} < 0$ .

<sup>6</sup> This is also a prerequisite for an estimation of the effects regulatory reform might have on the price-quantity interaction on parcel delivery markets. See OECD, 1996c, paragraphs 16 and 43.

Finally, public authorities have to provide resources in order to process import duties and taxes. The formal procedures of customs registration and border control involve substantial human resources as well as capital. According to the above cited AICES study, the customs authorities of the United Kingdom realise costs of approximately 9,7 £ per entry for express shipments. Given an average European Union import tariff of 4,5 % these costs would exceed the tariff revenues for shipments below a goods value of approximately 200 £. It should be kept in mind, however, that the collection of customs duties and value added tax in many cases is done simultaneously. Moreover, a comparison of tariff revenues and the cost of customs collection might implicitly point towards a justification of import duties as a general source of government revenue. Apart from the fact that this is questionable from an economic point of view, it is not an issue of relevance within the context of this paper.

Inefficiencies which may exist in many public sector bureaucracies, suggest that there is a potential for organising customs and tax procedures more efficiently. Transferring the collection of duties to private firms could be an approach which helps to minimise such inefficiencies. The Canadian Low Value Shipment Program, which is described below, indeed can be regarded as a way of partially privatising customs procedures and at the same time reducing the cost of such procedures at the firm level.

### ***The Canadian Low Value Shipment Program***

The Canadian Low Value Shipment Program<sup>7</sup> was developed with a view to reducing the costs of collecting taxes and import duties. For shipments which generate a relatively low amount of tax revenues and import duties, the administrative costs per item were disproportionately high. In fact, before the program was in existence, a foreign company which wanted to ship goods into Canada had to process customs and taxes on a discretionary basis handling each shipment separately. The goods had to be registered for import duty and value added tax collection at a central clearing office. After that, the shipments were transmitted to the postal system, where the recipients could pick them up after paying CAN\$ 5 postal processing fee (INDUSTRY CANADA, 1996).

With the Courier Program a much easier way of handling shipments came into effect. The program allows commercial carriers to collect duties and taxes levied on shipments with a value of less than CAN\$ 1600. Carriers which participate in the program report and pay the financial resources to Revenue Canada on a consolidated base each month. For example, a courier which processes 100.000 low value shipments per month into Canada, collects all the duties and taxes for these shipments from the customers, and forwards the total amount of revenue with one month delay to the Canadian authorities. Courier firms can take advantage of the program if they meet certain eligibility criteria (REVENUE CANADA, 1996a), as for example:

- i) The company must be a bonded carrier.
- ii) The company must have a physical presence in Canada, for example, it has to pay Canadian taxes, employ Canadians, etc.
- iii) The company must secure the payment of taxes and duties.

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<sup>7</sup> The term Courier Program is frequently used as a synonym for Low Value Shipment Program.

- iv) The goods eligible to the program are not prohibited, controlled or regulated and, as mentioned already, below a value of CAN\$ 1600.
- v) The company has a written undertaking from the importer.

Direct marketers which serve clients in Canada can take advantage of the program. For example, a mail-order company which is located in the United States can ship the goods into Canada by using the service of the bonded Canadian carrier. Taxes and duties are collected by the direct marketer. Then the revenues collected are transmitted to the bonded carrier, who is responsible for accounting and paying the duties to the Canadian authorities (INDUSTRY CANADA, 1996). The advantages of the new arrangement benefit the final consumers, direct marketers, the customs and tax authorities, and the parcel delivery industry:

- i) Because of competition in the mail-order business, the cost savings facilitated through accounting on a consolidated base should be passed on to consumers. In addition, the consumers no longer have to pay the CAN\$ 5 postal processing fee as mentioned above.
- ii) Moreover, the speed of delivery has been increased significantly: "... the average time elapsed from placing the order to delivery has been reduced from three days to one" (REVENUE CANADA, 1996b).
- iii) The cost savings to the customs and tax administration are significant. Government expenses for processing low value shipments have fallen by 46 %.
- iv) The increased volume of business that results from more cost-effective and speedy delivery should lead to a larger volume of business for direct marketers as well as parcel delivery firms.
- v) To the extent that the volume of business in direct marketing increases, the intensity of competition in retail distribution generally should increase as well.

The Low Value Shipment Program can be regarded as a partial privatisation of customs and tax procedures. The public authorities no longer collect duties for individual shipments below CAN\$ 1600, instead they allow private firms to do the administrative work and then report and pay ex post. As described above this approach facilitates large efficiency gains. However, one should keep in mind that the different treatment of low value and high value shipments might lead to distortions. Since the administrative cost and the delivery time of low value shipments decrease relative to high value shipments, the program affects relative prices as well as the quality of service in the mail-order business. Consumers might adjust their purchasing behaviour to the new relative price structure. Even if the suppliers on the market apply an average price calculation, in the sense that they pass on the reduced duty and tax processing cost to consumers by simultaneously lowering prices for low and high value shipments - a case in which relative prices might not be affected, the different speed of delivery for low and high value goods still would lead to a certain "bias" on the market. In the light of this, the question of whether simplified tax and customs procedures should be applied for high value goods as well seems to be appropriate.

### ***Duty Free Thresholds***

From the viewpoint of welfare economics, an elimination of customs duties is the optimal approach. Although duty free thresholds do not facilitate a complete free trade solution, they provide at least some liberalisation of international trade. By definition duty free thresholds apply only to a limited market segment up to a certain value of the goods in question. For example, the European Union allows duty free imports up to a goods value of about \$ 28 (ECU 22) and for imports into the United States a duty free threshold of 200 \$ applies (AICES, 1994).

The different treatment of goods below and above the duty free threshold, however, might lead to similar distortions as described in the context of the Canadian Low Value Shipment Program. The structure of relative prices is artificially affected by selective liberalisation, and households as well as firms might adjust their consumption pattern to the new price relations. Nevertheless, the economic benefits to be reaped from tariff-free trade for goods below the thresholds support the case for further trade liberalisation.

### **Costs for International Transport**

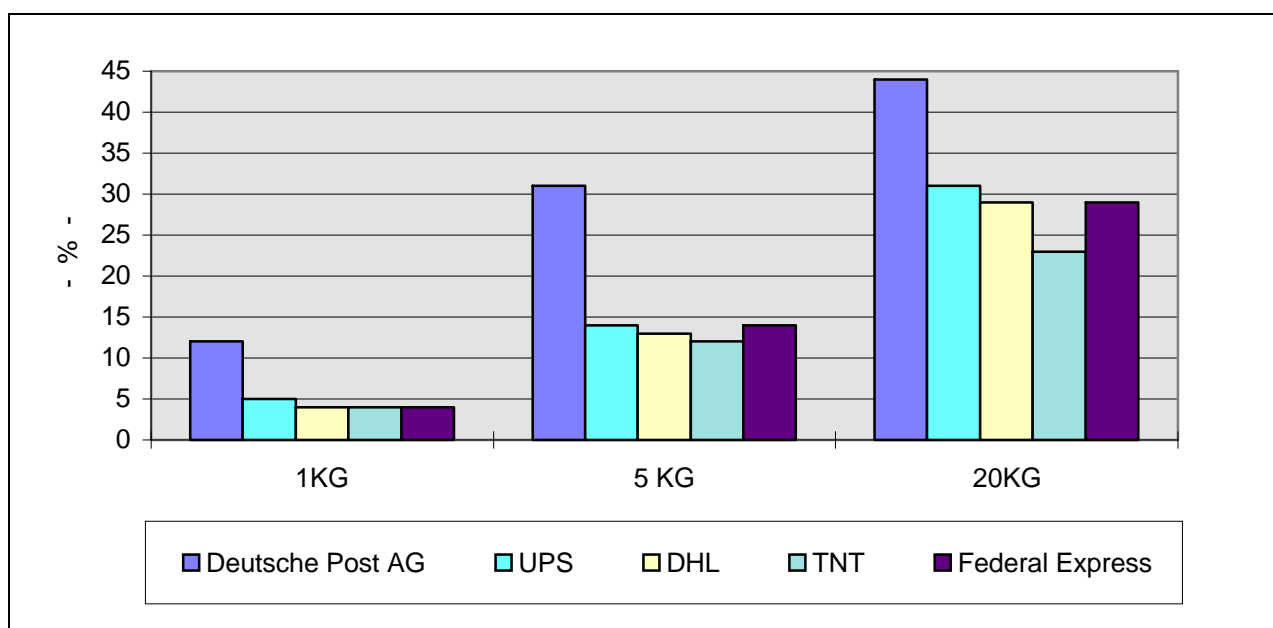
The international transport of parcels in principle can be carried out either by air, road, rail or marine transport. However, air transport seems to be prevailing in long distance parcel delivery. Transport via railway systems and automobiles can be assumed to be competitive in particular if the regional extension of the countries in question is not too large. This is the case in Europe where a parcel could take its way, for example, from Austria through Germany into the Netherlands, and the distance shipped would still be comparatively small. Against this background the following paragraphs will primarily address issues related to air transport. Road and railway transport will also be briefly addressed.

Since the late eighties, the rates for international air transport have dramatically decreased. For instance, the aviation fees for transport from Frankfurt to New York fell by nearly 50 % in 1990 and 25 % in 1991. Since then the rates have remained fairly stable. This development, which to a large extent was triggered by airline deregulation in the United States,<sup>8</sup> also reduced the cost for international transportation of parcels. This large decline points towards the conclusion that air freight fees might not be of outstanding significance. However, as the following explanation shows, such conclusion would be premature. For example, the absolute fee per KG air freight from Frankfurt to New York amounted to

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<sup>8</sup> See for instance VITA, 1996, p. 5; MC GOWAN and SEABRIGHT, 1989, pp. 286.

**Figure 1: Cost of Air Freight as a Percentage Share of Parcel Rates**



*Notes:* Prices for air transport from Frankfurt/Main to New York as a percentage of parcel rates for delivery from Germany to USA as given in Figure 1. The computed relations may be slightly biased, because the costs of transport are measured in 1994 prices, while parcel rates are collected in January/February 1996. The absolute value of cost for air freight is DM 5,71 per KG (up to 45 KG).

*Source:* OECD, 1996a, p. 10.

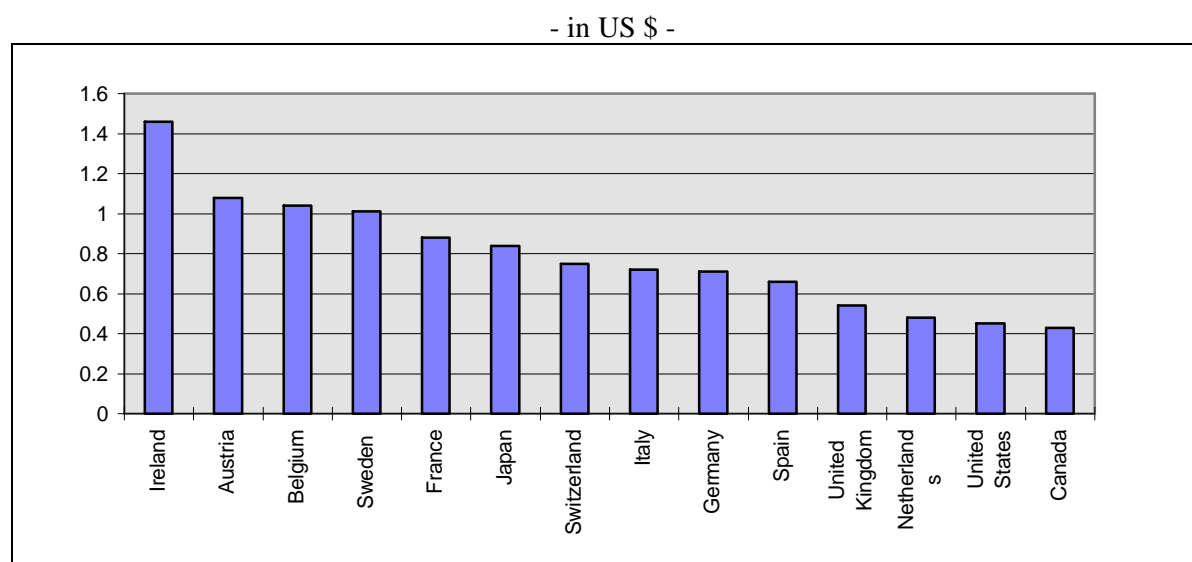
up to a weight of 45 KG. The parcel fee per KG charged by delivery firms, however, goes down as the quantity increases. This implies that with increasing parcel weight the percentage share of the cost for air transport in parcel rates goes up. The data in Figure 1 verify this result which for purpose of simplification DM 5,71 in 1994 provides information up to 20 KG only. The conclusion to be drawn from the data discussed in this paragraph is that the price for delivery of large weight parcels to a sizeable extent reflects the cost for air freight. Nevertheless, parcel firms that have their own airfleets might be able to minimise the impact of airfreight costs on parcel rates.

Despite the significant decline of international air freight fees, some room for lower rates still might exist. As can be seen from Figure 2, large differences with respect to the operating expenses per available ton kilometre in air transport exist. For example, in Ireland the operating costs for air transport account for some \$ 1,5 per ton KM, and are about two times as high as in Switzerland. Canada seems to realise the lowest operating expenses (\$ 0,43). One should keep in mind, however, that the data do not reflect total costs. Fixed costs like (airport infrastructure, etc.) are not included. Moreover, the comparability of the data might be limited due to the different sizes of the countries in question. Nevertheless, the large differences in operating expenses raise the question, of whether regulatory reform in high cost countries might be appropriate in order to reduce air freight fees.

Parcel delivery via road freight in principle can be a competitive alternative to air transport. In various countries, however, the road freight sector does not seem to have realised the most efficient cost structure. Until the seventies road transport was heavily regulated in most OECD-countries. Market entry was strictly controlled, licensing requirements were prevailing on certain routes, and cabotage was not

allowed in many cases (OECD,1996b, p. 15). Such regulations protected the sector from competition and therefore led to cost-inefficiencies. As a response to this outcome, however, some countries have partly

**Figure 2: Operating Expenses per Available Ton Kilometre in Air Transport**



*Note:* Data refer to 1993.

*Source:* OECD, 1996b, Table 2.3

liberalised the road transport sector thereby allowing for more competition. For example, the United States' "Motor Carrier Act" (1980) has eliminated many barriers to entry into the road transport business (VITA, 1996, p. 6). As the result the number of carriers increased substantially and prices fell by some 20 % (OECD, 1996b, 16). Other countries, as for instance France (1987) and already some years earlier the United Kingdom (1968), have also deregulated parts of their road transport systems, facilitating lower prices. Nevertheless, a potential for further deregulation still seems to exist in many countries. More competitive markets for road transport might help to reduce parcel rates.

Railway systems are another alternative for transporting parcels internationally. In many OECD countries, however, long distance railway transport is a public monopoly. Since inefficiencies have emerged, regulatory reform of rail transport might be appropriate in some countries. Among the policy options that are discussed, privatisation and reduced barriers to entry figure prominently. The likely reduction of prices and cost in railway systems that might result from such policies would also facilitate lower parcel rates.

### Policy Considerations

There is evidence that the high cost for international parcel delivery to a large degree are attributable to costly administrative processing of import and value added tax collection as well as the regulatory situation of markets for international transport.

- i)* Customs and value added tax procedures generate social costs on three levels. First, the paperwork to be completed by parcel delivery firms and the collection of duties by these firms leads to substantial costs, which can be assumed to be passed on to consumers. Second, administrative delays at the customs border lead to extended delivery periods which are to the disadvantage of consumers. Third, the public authorities have to employ capital and labour in order to manage customs and tax procedures.
- ii)* Given the above mentioned cost-inefficiencies of customs clearance and value added tax procedures, a privatisation of such services might be appropriate. The Canadian Low Value Shipment Program can be viewed as a partial privatisation. It allows private firms to collect duties for shipments below CAN\$ 1600 goods value and pay them to Revenue Canada on a consolidated basis. However, the different treatment of low value and high value shipments under the Courier Program might lead to distortions of relative prices which might be similar to the effects duty free thresholds exert on relative prices.
- iii)* Furthermore, continued deregulation of markets for international transport might help to lower parcel rates. Despite significant deregulation of the air transport and road freight sectors which have been implemented in the past, further policy moves towards more competition might be appropriate for facilitating lower parcel rates.

### **Further Work**

Further investigation of issues specifically related to international parcel delivery is appropriate in order to develop a broader basis for policy recommendations. The following areas seem to be most relevant:

- i)* The impact of customs and value added tax procedures on international parcel rates. Comprehensive and reliable data in this field, which so far are not available, are a pre-requisite for such research. Furthermore, consistent policy options for a reform of customs and value added tax procedures could be developed.
- ii)* With respect to the cost of international transport, a close review of work that is in progress at the OECD is appropriate. The OECD is currently focusing on the markets for air and road transport which are analysed within the context of the regulatory reform project. The results could be integrated into the OECD parcel project.
- iii)* An assessment of the effects, which lower parcel rates might have on the volume of business would be based on estimates of the price elasticity of demand for parcel shipments. This requires time series data on the number and weight of shipments as well as on parcel rates. Such data as well as the information on customs and value added tax procedures mentioned under (i) might be provided by parcel delivery firms and public post offices.

## *Appendix*

### **International Parcel Rates**

As an example for the magnitude of international parcel rates, Figure A1 and A2 provide an overview over the prices for shipment from Germany to France, Japan, the United States and Australia (air transport). The data reflect prices for individual shipments which are not reduced due to large quantity discounts. It should be noted that prices for different speeds of delivery were collected (see explanations at the bottom of the graphs). The data allow price comparisons in several important respects:

- i)* Quantities measured in KG (1 KG, 5 KG, and 20 KG).
- ii)* Distance shipped (from Germany to France, USA, Japan, Australia).
- iii)* Speed of delivery (normal service UPS, Deutsche Post AG versus express service TNT, FedEx, DHL).
- iv)* Customs regimes (no duty for Germany to France versus duties in overseas delivery).
- v)* Considerations of public versus private ownership (Deutsche Post AG versus UPS).

With respect to the quantity measured in KG, the data in Figure A1 show an absolute price increase as the parcel weight goes up. Irrespective of the delivery firm and the country of destination, the prices for 20 KG parcels are highest.<sup>9</sup> Not surprisingly the prices for parcel delivery also go up in correlation with the distance shipped. This general result is robust irrespective of the particular supplier of delivery service. For example, a TNT express parcel of 5 KG weight from Germany to France costs DM 191 compared to DM 421 for a shipment to Australia. Even if one preferred a longer delivery period and therefore sent the parcel, for instance, with the normal service of Deutsche Post AG, DM 45 had to be paid for delivery to France and DM 147 for transport to Australia. The price data point towards the conclusion that the value of products to be sent by parcel probably must be fairly high in order to ensure an “appropriate” relationship to parcel fees. Unless that critical value is reached, consumers will demand parcel delivery services only in cases where no domestic substitutes are available or where the goods in question are indispensable.

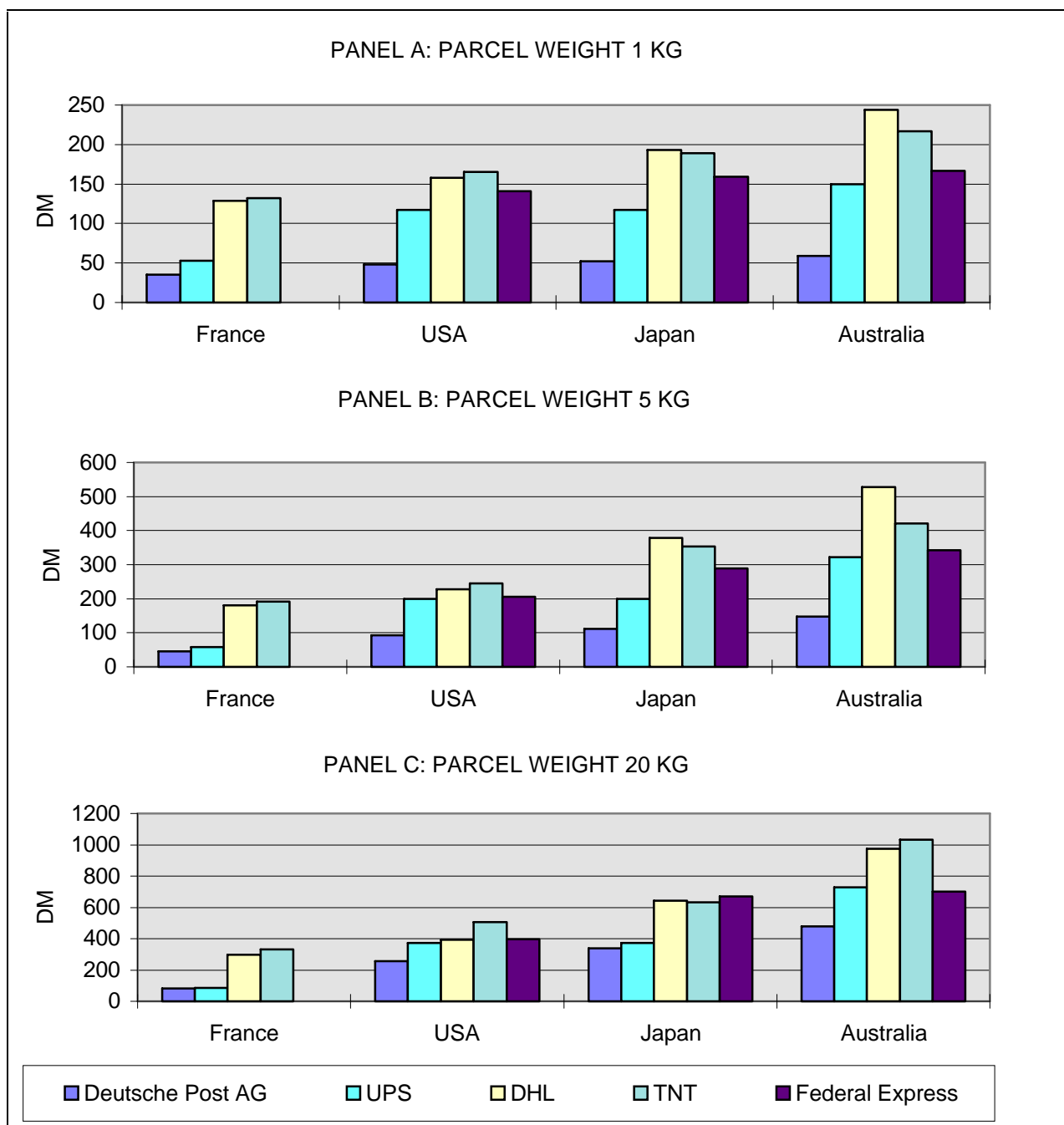
Cost figures should be evaluated against the quality of output. In principle, a superior service requires larger inputs than an average quality service. With respect to parcel shipments the delivery time can be regarded as the most important indicator for the quality of output. It seems that in most Member countries the delivery time needed for public delivery exceeds delivery periods of private firms. The World Wide Expedited Service of UPS, for example, manages a parcel normally within approximately 5 days between the United States and Germany, and in addition it is possible to obtain current information about the concrete location of that parcel at any given time. In contrast, the United States Postal Service

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<sup>9</sup> It should be noted that the suppliers of parcel delivery also offer services for much heavier parcels. Prices for shipments of 100 KG and more could be presented. For two reasons, however, this paper deals with shipments up to 20 KG only. First, the economic results would not change if heavier parcels were taken into consideration. Second, the bulk of shipments can be expected to be carried out in smaller weight categories.

needs between 7 and 10 days for a similar operation (VITA, pp. 14). This might contribute to explaining the comparably low prices charged by the public suppliers.

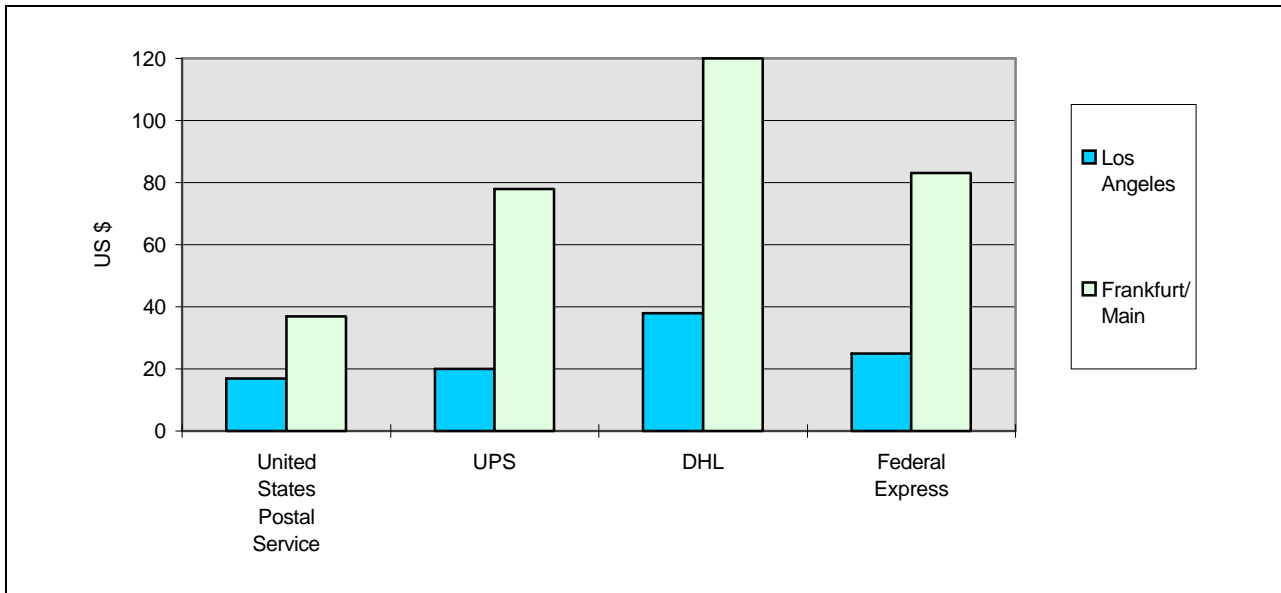
**Figure A1: Rates for Parcel Shipments from Germany to France, USA, Japan and Australia**



Notes: Shipments from Cologne/Bonn to the country of destination. TNT, DHL, Fed Ex: Express service with speed of delivery between two and three days (approximately), depending on the country of destination. UPS: Euro and Worldwide Expedited with speed of delivery about four/five days (approximately, not guaranteed). Deutsche Post AG: Premium Parcels with speed of delivery up to 10 days. Data reflect prices for air transport.

Source: OECD, 1996a, p. 7. For delivery times see also VITA, 1996, pp. 14.

**Figure A2: Rates for Parcel Shipments from New York to Los Angeles and Frankfurt**



*Notes:* Prices for delivery of a single 7 lb. package containing dutiable merchandise of value \$ 100, door to door delivery. United States Postal Service: 2-day delivery to Los Angeles, 7-10 day delivery to Frankfurt. UPS: 2-day delivery to Los Angeles, 2-day delivery to Frankfurt. DHL: Overnight to Los Angeles, 2-day to Frankfurt. Federal Express: Domestic standard to Los Angeles, 2-day to Frankfurt.

*Source:* OECD, 1996a, p. 11.

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## REGULATORY REFORM FOR MORE EFFICIENT PARCEL DELIVERY MARKETS

Dr. Winfried HORSTMANN

### Introduction

At the 1994 OECD conference "A Global Market Place for Consumers" problems related to both national and international parcel delivery figured prominently: "Costs and delays associated with cross-border parcel delivery can be a major disincentive for consumers wanting to make purchases from other countries" (OECD, 1995a, p. 31). In fact, a common feature of parcel markets in Member States is that the rates for international shipments usually are significantly higher than the rates for comparable domestic services. For instance, shipping a 3 1/2 KG parcel with the United States Postal System from New York to London is more than two times as expensive as a shipment from New York to Los Angeles, although the distance is similar. In some cases international shipment can be about four times as expensive as domestic delivery (OECD, 1995, p. 12; VITA, 1996, pp. 14). Furthermore, the prices for parcels that private firms charge in general are higher than the prices of public suppliers. The observed price differentials raise the question of which factors determine parcel rates, and which policies should be adopted in order to facilitate lower prices for parcel delivery.

National case studies and other country specific material provided by Canada, Germany, the United Kingdom, and the United States indicate that regulation of postal services is a significant cause of high parcel rates. The work carried out by various international organisations to some extent seems to support this view: A study by the World Bank, which was discussed at a recent conference of the Universal Postal Union, arrives at the result that - apart from technological and enterprise reform - a regulatory reform of postal systems is necessary in order to strengthen the efficiency of postal services (RANGANATHAN, 1996). In the European Community the postal reform issue is being debated, and the work of the European Commission contains proposals for restructuring the postal system (COMMISSION OF THE EUROPEAN COMMUNITIES, 1992, pp. 11; MAUSSIAN and MOSCA, 1994, pp. 70).

With a focus on parcel delivery the OECD Committee on Consumer Policy can make a substantial contribution to the international discussion on regulatory reform of postal systems around the globe. Due to the fact that the services for delivery of parcels, letters and postcards are interlinked, for example via cross-subsidisation, the discussion cannot be confined exclusively to parcel delivery. Consequently, the issues that are addressed in this document include:

- i)* A discussion about the size of the relevant market based on the German case.
- ii)* A brief review of the theories of market and state failure, for example, public goods properties and natural monopoly arguments.
- iii)* A discussion of the significance of scale economies and economies of scope for regulatory reform of postal systems.
- iv)* An overview about current regulation of postal systems in selected Member countries.
- v)* Political considerations for regulatory reform.

## Market Shares and the Size of the Relevant Market

One of the most controversial issues in parcel delivery deals with the size of the firms' market shares. In some Member countries, public post offices seem to hold relatively large market shares which according to the view of private firms are to a large extent the result of cross-subsidisation (FEDERAL EXPRESS, 1995; STEINMETZ, 1996)<sup>10</sup>. Most interesting is the situation in Germany, where two alternative concepts for the definition of the relevant market are discussed. Private firms, as for example UPS, Hermes, and German Parcel, which supply parcel delivery services in Germany since the mid seventies, base their calculation of market shares on a narrow definition of the relevant market. In this case the potential volume of internal freight transport and distribution systems of secondary sector firms (for example producers of electronic components who send parts internally) are not taken into consideration. The total number of shipments in 1995 then accounts for roughly 1 Billion (Figure 1, Panel A), and the market share of private parcel delivery firms appears to be about one third. The public post office, Deutsche Post AG, under this assumption holds a market share of 68 %. Assuming a relatively high price elasticity of demand on the market for parcel shipments, private firms claim that (subsidised) lower parcel rates of the public post office facilitate a larger volume of business for Deutsche Post AG.

An assessment of the relevant market by the Deutsche Post AG leads to significantly different results. The Post AG bases its estimates on the entire volume of goods transport services in Germany which also includes shipments by the internal freight transport systems of private sector corporations. Most large companies, as for instance, Mercedes Benz, VW and Hoechst, have invested in large-scale transport facilities that ensure the timely delivery of inputs in order to continuously feed the production process. Obviously, the Post AG considers this as a market that in principle can be exploited by specialised parcel transport services. In this case the market share of Post AG declines to some 27 % and the total number of shipments amounts to 2,5 Billion in 1993 (Figure 1, Panel B).

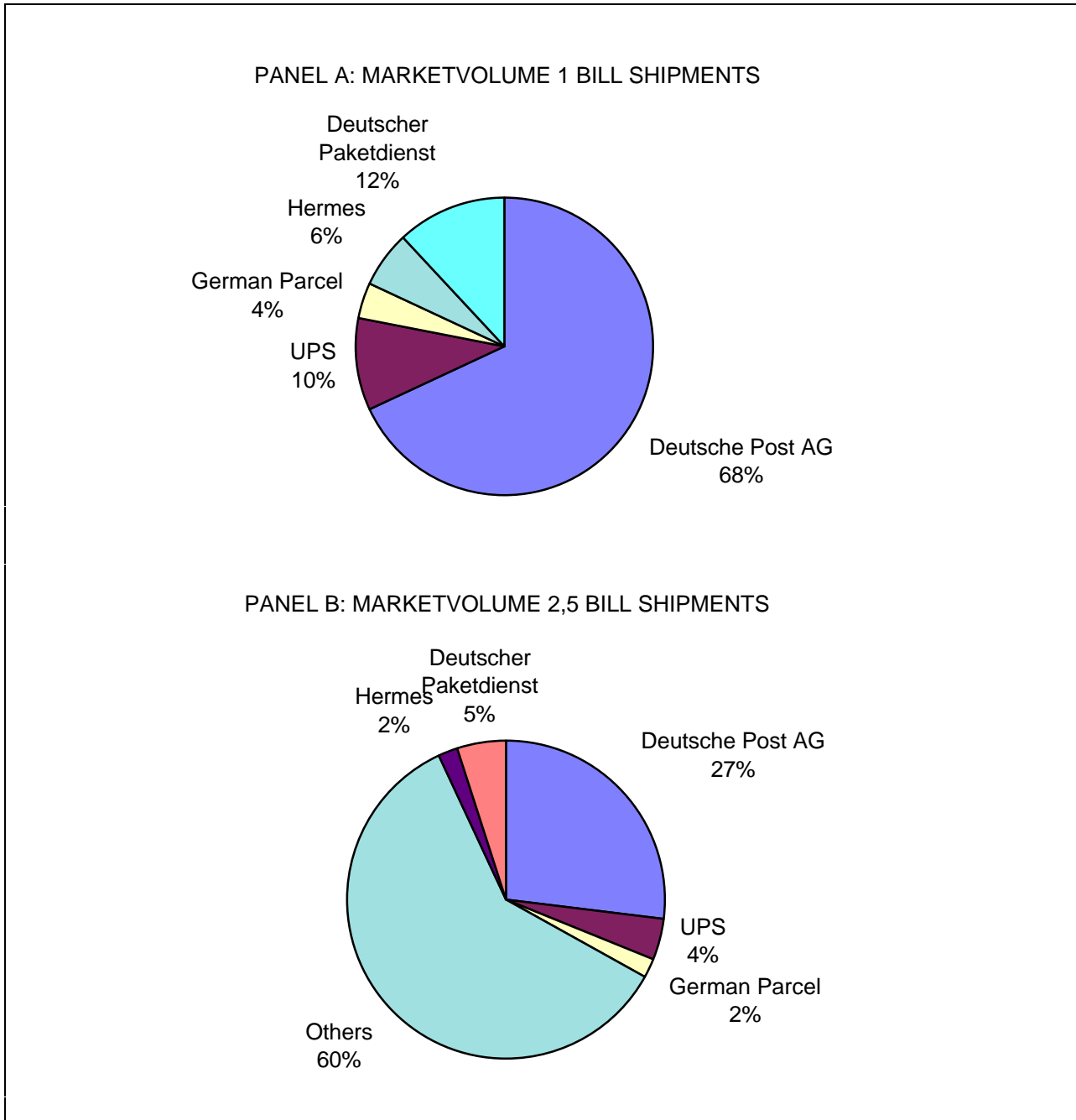
The numbers given above are subject to some caveats, the most important of which is the strategic interest that firms may have in downplaying their effective market power. Moreover, the data cover domestic shipments only, and concrete data on the number of international shipments are missing. However, despite the existing data problems the numbers given in Figure 1 provide some useful information. For example, the discussion of the size of the relevant market makes it possible to draw some conclusions about the competitive situation in parcel delivery. The fact that the state-owned supplier on the one hand and private firms on the other arrive at fundamentally different conclusions in the sense that they each adopt a position which makes the own market-share appear smaller, can be regarded as an indication that firms are strategically aiming at attracting larger market shares. This points towards the conclusion that the public supplier and the block of private firms are competing against each other.

The key result that can be derived from the above discussion, however, is that independent of the definition of the relevant market the Deutsche Post AG has an overwhelmingly large market share as compared with private parcel delivery firms. Against this background the question of whether regulatory reform could contribute to establishing a "level playing field" on the market for parcel delivery indeed seems to be appropriate. In various Member countries evidence of cross-subsidisation in parcel delivery exists, and a more market-oriented regulatory framework of postal systems - as mapped out in Section 5 - might contribute to abolish such distortions to competition (COMMISSION OF THE EUROPEAN COMMUNITIES, 1992, pp. 122; MAUSSION and MOSCA, 1994, p. 70).

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<sup>10</sup> For a discussion of the cross-subsidization issue within the context of the European Commission's Green Paper see EUROPEAN EXPRESS ORGANISATION, 1995, pp. 193. Tests for cross-subsidies are explained in SIDAK and SPULBER, 1996, pp. 107.

**Figure 1: Estimates of the Relevant Market for Parcel Shipments in Germany (1993)**



Notes: Panels A and B are based on different assumptions with respect to the size of the relevant market. See explanations in the text, paragraphs 4 and 5.

Source: OECD, 1996, p.4.

## **Theoretical Considerations**

The basic argument that has traditionally been put forward in order to justify regulation of postal and telecommunication services stresses a certain need to safeguard “uniform spatial living conditions”. According to this argument people who live in rural areas should pay the same price for parcel and letter delivery as the inhabitants of large agglomerations. Other reasons for government intervention into the postal system that are frequently put forward are based on public goods properties, externalities and natural monopolies. These issues have been extensively scrutinised in the literature on market failure. A different approach, which prepares the ground for a more critical position with respect to government intervention, has been developed in research on bureaucracy and state failure. The purpose of this section is to assess the regulatory situation on Member countries’ markets for postal services against the background of the above mentioned theories. Furthermore, the significance of economies of scale and scope that could be reaped from regulatory reform needs to be discussed.

### ***Market versus State Failure***

In a well functioning market for postal services prices should reflect the cost of production. These include the cost for collecting, transporting, and distributing parcels and letters. Extra costs that are associated with delivery to some rural area therefore should raise prices above the average. This however, is frequently regarded as a contradiction to the principle of “uniform living conditions”. This principle as well as social considerations figures prominently as a justification for the regulation of postal and telecommunication services. The underlying policy argument is that price differentials with respect to varying transportation distance would discriminate against the inhabitants of rural areas. Since market forces normally do not warrant a uniform price in the presence of cost differences, the market is assumed to fail with respect to the above mentioned principle. However, this view seems to be purely normative, and a different evaluation of spatial price differentials is possible. First, such differentials should be assessed against the economic advantages people enjoy when living in a rural area which include, for example, comparatively low rents and house prices (see also paragraph 13). Second, price differentials with respect to different spatial conditions help to ensure an efficient regional factor allocation. They are a prerequisite for efficient land use (DICKE, GLISMANN and HORN, 1995, p. 6).

A widely used rationale for regulating postal services is based on foregone infrastructural externalities. As in the above mentioned case of uniform living conditions, the chain of reasoning starts with pricing that truly reflects transport costs. Such pricing would provide an economic incentive for people to leave the countryside and relocate to some urban area where the costs for communication are lower. In that case the population of rural areas would decrease, and in the long-run the quality and density of the infrastructural network - for example, transport, healthcare, and educational facilities - in the countryside might decrease as well. To the extent that such facilities produce positive externalities, in the sense that they benefit not only the local municipalities in question but a much wider range of individuals, a deteriorating infrastructure implies social losses. The obligation to serve the entire country with parcel delivery at a uniform price, which is part of the regulation postal services normally are subjected to, therefore can be seen as an attempt to subsidise the production of infrastructural externalities. One of the key problems of the externality view, however, is that objective criteria for a quantitative assessment of externalities are not available. Any evaluation of the social cost associated with foregone externalities therefore remains somewhat arbitrary.

Another rationale for justifying regulation is based on the public goods case, which has some similarities with situations where positive externalities exist. In the pure public goods case, exclusion of users via the price mechanism is not possible and non-rivalry in consumption is given (ATKINSON and

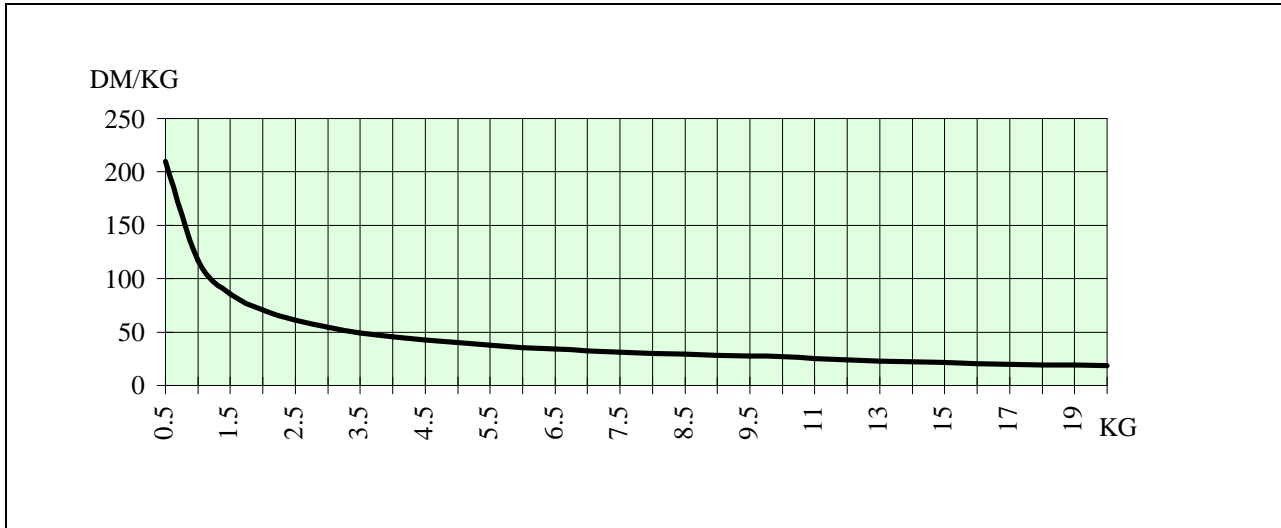
STIGLITZ, 1980, pp. 483). Free-rider problems exist because it is virtually impossible to prevent individuals from consuming without paying. One important thing to be kept in mind is that the term “public good” is defined from a users’ perspective, which means that in principle not only government but also private firms can supply such goods. The free-rider problem, however, implies that the private sector probably would not supply a sufficiently large quantity of public goods. Therefore, the argument goes, government has to guarantee sufficient supply. Obviously, this way of reasoning does not apply to postal services, because exclusion of users via the price is possible and free-riding is not feasible.

The natural monopoly case is another standard reason provided in favour of regulation. It describes a situation where production technology causes a falling long-run cost curve. A large block of fixed cost leads to decreasing unit cost even for very large output numbers. In the long run only one single firm, the natural monopoly, could serve the market (NOLL, 1992, pp. 1255). In order to prevent private sector monopoly pricing, public ownership of the monopoly in question and/or price regulation is proposed. Production technology and cost curves in postal services, however, do not seem to justify any regulation based on natural monopoly assumptions. Although there are areas of decreasing unit costs, more than one supplier normally is able to earn profits in the market. This becomes particular evident in long-distance transportation. Many public post offices rely on competitive private carriers, for example airlines. Such arrangements contradict the natural monopoly argument (SIDAK and SPULBER, 1996, pp. 43).

Although there are some sectors of the economy to which the above mentioned market imperfections apply, market failure does not seem to play a major role with respect to postal services. Instead several arguments in favour of deregulation must be taken into consideration. The findings of the theory on state failure indicate - among other things - the following shortcomings of government intervention: First, the amount of inefficiency associated with intervention of public authorities normally is large. Second, a government regulatory authority hardly has superior knowledge on the precise price that has to be applied in order to cover average cost. Third, regulation in general is subjected to various influences (interest groups, etc.) which can run counterproductive to efficient regulation (NISKANEN, 1971; NOLL, 1992). If despite these caveats, uniform living conditions are considered as a goal in itself, a direct income transfer to people who live in rural areas is the superior method for achieving this. A common result of welfare economics is that the distortion to product markets remains relatively small in the case of direct income transfers, because the recipients make independent decisions about the use of the transfer.

Probably the most powerful argument against government intervention into the postal system deals with the definition and the economic consequences of monopoly rights. Airtight criteria for identifying the appropriate size of monopoly areas needed to finance losses that arise from universal service obligations are missing. This has motivated a tendency to define monopoly rights generously in order to ensure profitable operations of the entire postal and telecommunication system. Monopolistic market structures, however, are conducive to organisational slack and cost raising X-inefficiencies which seem to be of major importance in public enterprises (LEIBENSTEIN, 1966; PERA, 1989, p. 170). These effects are of even greater significance in cases where barriers to entry are high or prohibitive (as in public monopoly cases), so that the threat of potential competition by new firms that might enter the market does not exist. Significant losses of consumer welfare associated with monopoly pricing and inferior quality of output therefore seem to prevail on markets supplied by a public monopoly.

**Figure 2: A Representative Price - Quantity Relationship**



*Note:* The curve given above reflects prices for delivery of the UPS Worldwide Expedited Service, Cologne to New York. An asymptotically falling price per KG seems to be a common characteristic of the pricing policy in the market. For reason of simplification the curve covers the area up to 20 KG is only.

### ***Economies of Scale and Scope***

Scale economies are among the most important factors that influence the size and the number of firms operating on a certain market. Higher levels of output facilitate a reduction of unit cost, because fixed investment expenditure per unit of output decrease. Additional product specific scale economies can be reaped if mass-production allows for an extended specialisation of workers. Figure 2 serves as an example for the decline of prices per unit of output that can be achieved as the quantity increases. Further evidence on the existence of scale economies may be derived from the prices mail-order companies charge for parcel delivery. Delivery prices of such companies, which often send millions of parcels per year, are comparatively low. This becomes even more obvious if one takes into account that the rates also include the cost for packaging and preparing goods for shipment. It is important to keep in mind, however, that mail-order companies to some extent might incorporate the fee for shipments in the price of the goods that are ordered by customers.

The existence of scale economies can have strong implications for regulatory reform. Given a sufficiently large (negative) price elasticity of demand for parcel shipments, price decreases that might come into being in the event of regulatory reform facilitate a larger volume of business. This would enable parcel delivery firms to reap scale economies which in the presence of competition would transform into another round of falling prices. In a nutshell: Regulatory reform could trigger a spiral of decreasing prices and increasing volume of business, which would continue until the price equals marginal cost. Consumers, parcel delivery services, and direct marketers would benefit from such dynamism. However, the significance of this process crucially depends on two conditions: First, substantial economies of scale are necessary, and second, the price elasticity of demand for parcel services must take a sufficiently large negative number. A challenge therefore exists, to collect data which allow to test these two conditions and to quantify the adjustment process as described above.

Economies of scope are another important feature of the production technology employed in postal services. A firm can reap economies of scope if joint production of several distinct products is more cost effective than the production of each item in isolation.<sup>11</sup> For example, in all main product categories, such as letter freight, postcard and parcel delivery, modern transportation machinery is needed. A use of transport facilities for combined delivery therefore can be expected to lead to a reduction of unit costs. For instance, the part of the delivery process where one worker drives shipments around from door to door might be most cost-effectively organised if parcels, postcards and letters are delivered simultaneously. Economies of scope could also be reaped via combined air transport of letter freight and parcels. In various Member countries, however, joint transport and delivery of distinct items can only be done by the public competitor, because the transport of letters and postcards basically is reserved for the public sector. Against this background economies of scope should be regarded as a rationale for liberalised postal systems. In fact, they "... do not justify extending the postal monopoly. On the contrary, the presence of economies of scope would more plausibly imply the need to *eliminate* the postal monopoly. There are currently private carriers of express mail - such as Federal Express and United Parcel Service, to name only two - that are not permitted to carry standard letter mail" (SIDAK and SPULBER, 1996, p. 57).

Future developments on the markets for postal services, however, might lead to a relative decline of letter freight, which could limit the potential for economies of scope. In fact, the extent to which economies of scope in Member countries' postal systems exist, very much depends on the effects of modern telecommunication technology on letter freight. Recent research has shown that the transition of information in particular via telefax results in a substitution of letter mail. In Germany, written communication between firms is more and more done by telefax, which provides a relatively time-efficient and cheap way of exchanging information. Communication via e-mail, however, so far is of relatively minor importance. The extent of substitution differs very much across the sectors of the economy. A particularly large potential for substitution seems to exist in some service industries as for example, banking and insurance. Local governments and social security institutions also seem to make extensive use of telecommunication media (PLUM, 1996, p. 75). In addition a certain potential for a substitution of letter mail can be observed in private households (BALDRY, 1996, pp. 53).

One should keep in mind, however, that the total impact of modern telecommunication technology on the volume of letter freight could be ambiguous. It is possible that the strong growth of fax and e-mail communication, as well as other telecommunication media, stimulates a certain complementary increase of letter freight (PLUM, 1996, p.1). For example, advertisements which are sent over the Internet might lead to requests of consumers for more detailed material about the specific goods they are interested in. This could trigger additional letter and catalogue mail containing product information. Hence, even a process of mail creation could come into being during which the use of telecommunication media increases strongly, and at the same time a slight growth of letter freight might come into being.

Certain limits exist for mail substitution and creation. For example, traditional letters will remain the most appropriate form of written communication in cases where an original signature is necessary. Such letter mail can hardly be substituted by electronic communication. However, fax and e-mail are much faster ways for exchanging information than letter mail, which means that the creation of letter freight is limited as well. The general picture indicates that to a certain extent a substitution of letter mail might come into effect, which very much depends on relative prices of traditional letter freight and modern telecommunication media. However, a substantial market for letter freight still will remain.

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<sup>11</sup> A precise definition of economies of scale and scope can be found in SPULBER, 1989, pp. 113.

In the light of this, a possible approach to regulatory reform of postal systems would aim at abolishing public monopolies in letter freight (Section 5). This would open up room for private carriers to reap economies of scope from the combined delivery of letters, postcards, and parcels. A first important effect would consist of a decline of parcel rates . Secondly, increased competition in letter mail may facilitate lower fees on this market as well. In this case, the ratio of letter freight fees over the prices for the use of telecommunication media might change in favour of letter mail (decrease), and substitution of letter mail then would progress at a slower pace. This, however, means that the potential for economies of scope which could be reaped via the joint delivery of distinct postal items probably would not be eroded through a substitution of letter freight by increased use of telecommunication technologies.

### **Current Regulation**

Postal systems in Member countries have various common features. A mix of monopoly rights granted to the public sector and universal service obligations prevails in national markets for postal services. The following overview covers Canada, Germany, the United Kingdom, and the United States. This selection is not meant to be exclusive, the four states mentioned serve as examples for regulation of postal systems. Box 1 summarises some key regulations of letter and parcel delivery in these countries.

**Box 1: Regulation of Parcel and Letter Delivery in Selected Member Countries**

	CANADA	UNITED STATES	UNITED KINGDOM	GERMANY
COMPETITORS	Canada Post Corporation (state-owned), several private firms	United States Postal Service (state-owned), several private firms	Royal Mail, Post Office Counters, Parcelforce (all state-owned), several private firms	Deutsche Post AG (state-owned), several private firms
LETTER DELIVERY	Monopoly rights for Canada Post Corporation (basically all letters except urgent mail, and except letters with postage more than three times the fee of a fifty gram letter)	Monopoly rights for United States Postal Service (discretion with respect to what constitutes a letter)	Monopoly rights for Royal Mail (covering letters up to £1 postage)	Monopoly rights for Deutsche Post AG (for letters with postage up to the tenth of standard letter, and for large-quantity letter freight up to 0.1 KG weight)
PARCEL DELIVERY	Universal service obligation for Canada Post Corporation	Universal service obligation for United States Postal Service	Universal service obligation for Parcelforce (covering shipments of more than £1 postage)	Universal service obligation (covering shipments up to 20 KG weight)
REGULATORY AND SUPERVISORY AUTHORITIES	No explicit regulatory authority, supervision by government	Postal Rate Commission. However, the United States Postal Service's Board of Governors can overrule Postal Rate Commission	Department of Trade and Industry	Bundesanstalt für Post und Telekommunikation which is supervised by responsible Ministry, Regulierungsrat

*Note:* The information provided in this Box is meant to provide an overview of key regulations and is not intended to be exhaustive.

## *Canada*

The Canadian postal system has traditionally operated as a department of federal government, before it was changed into a federal Crown corporation in 1981. As a 100 % state-owned entity, Canada Post Corporation employs about 62,000 full and part-time staff and provides service through 18,500 points of access. The corporation is free to raise funds on the capital market and can pay dividends to its shareholder, the government (SIDAK, 1996, pp. 6). However, Canada Post has frequently realised losses. For example, the accumulated deficit during the period from 1991/92 to 1994/95 accounted for CAN\$ 441 Mio (CANADA POST CORPORATION, 1996, p. 24).

A statutory monopoly for delivering letters has been granted to the public supplier. According to the Canada Post Corporation Act, the exclusive right for collecting, transporting and delivering letters does not apply, however, to “letters of an urgent nature that are transmitted by a messenger for a fee at least equal to an amount that is three times the regular rate of postage payable for delivery in Canada of similarly addressed letters weighing fifty grams” or to “letters in the course of transmission by any electronic or optical means” (SIDAK, 1996, p. 11). The economic justification put forward for this regulation is based on natural monopoly properties that are assumed to apply to the Canadian postal system. Doubts about the validity of this assumption, however, have been raised. In its recent submission to Canada Post Corporation the Canadian Competition Bureau “suggests that postal services would be provided more efficiently if the exclusive privilege were removed.” In this case “private companies were allowed to enter the market and compete with Canada Post in letter mail delivery” (COMPETITION BUREAU CANADA, 1996, p. 51).

In parcel delivery, express mail, and electronic or optical communication the Canada Post Corporation is obliged to provide universal service. Given the large size and low population density of the country, the economic justification for this regulation seems to be somewhat stronger than in smaller countries.<sup>12</sup> One should keep in mind, however, that universal service does not necessarily mean door to door delivery. In rural areas, Canada Post Corporation has established collection points to which the mail is delivered. And in suburban neighbourhoods the mail is often placed in “community or cluster mail boxes”, to which the recipient may have to walk for purpose of collecting his mail (SIDAK, 1996, 35).

The property rights situation of the Canadian postal system is disputed. In accordance with the common experience that public ownership often leads to inefficient use of resources, it has been argued that privatisation of Canada Post would raise efficiency. Moreover, government ownership seems to affect competition between Canada Post and private firms in an asymmetric way. Under the current regime, Canada Post may borrow funds directly from the public sector, thereby taking advantage of government credibility and comparably low interest rates. Moreover, the government directly subsidises Canada Post. For example, in 1994 CAN\$ 115 Mio were granted to the public corporation as a compensation for delivering Parliamentary mail, literature to the blind, as well as food shipped in the North (SIDAK, 1996, pp. 9).

An interesting question to be addressed is whether the Competition Bureau’s recommendations for reforming Canada’s postal system could serve as a general blueprint for reform of postal systems. In particular, the natural monopoly argument that in many countries serves as a standard justification for reserved areas may be reconsidered in the light of the Canadian experience. It seems that even in countries of large size, like Canada, the transportation and sorting technology employed in postal services does not

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<sup>12</sup> In addition, the regional concentration of the population is relatively high in Canada. The majority of the twenty-eight million Canadians live in relative proximity to the United States border.

lead to long run falling unit costs. The experience with transportation services “which are supplied in highly competitive markets” suggests that postal services could also be provided effectively in competition (COMPETITION BUREAU CANADA, 1996, pp. 17).

### *Germany*

Since 1989 the institutional structure of postal and telecommunication services in Germany has been adjusted with two legislative initiatives<sup>13</sup>. Today the three branches - postal services, telecommunication, and postal banking - are run by three different joint-stock corporations, each of which is entirely state-owned. The corporation that supplies postal services is the Deutsche Post AG, with about 371 thousand employees (1993). Deutsche Post AG operates under the protection of a monopoly regime for letter and postcard delivery up to a current ceiling of 10 DM. Moreover, large-quantity letter-freight up to 0.1 KG per letter is exclusively reserved for the Deutsche Post AG. The corporation is traditionally unprofitable.

An obligation exists to provide universal service on several markets. With respect to parcel delivery the regulation comprises the following two elements. First, the Deutsche Post AG has to transport parcels up to 20 KG weight to every place in Germany (compulsion to contract). Second, an identical delivery fee has to be applied nation-wide (uniform price requirement). However, the regulatory framework allows for some exceptions from this rule: First, the universal service obligation does not apply to shipments from Germany to foreign countries. Second, mailings which require special provisions, for instance, in the case of dangerous goods delivery, are exempted. Third, the compulsion to universal service does not cover parcel shipments that are pre-sorted by clients.

One of the greatest advantages the Deutsche Post AG enjoys against its private competitors in parcel delivery arises from the possibility of cross-subsidisation. The regulatory framework allows for transfers from the profitable monopoly areas to loss-making operations (DICKE, GLISMANN and HORN (1995, p. 18). Other fields on which regulation is asymmetrically affecting competition in favour of the public supplier can also be identified. First, the Deutsche Post AG is exempted from paying value added tax, worth 15 % of turnover. Second, according to the information of private parcel delivery firms, the trucks of the Post AG are allowed to park for free while private firms have to pay for parking tickets. Third, private suppliers of parcel delivery must pay for car inspections while the public corporation enjoys an exemption (STEINMETZ, 1996).

On 8 May 1996, a new “Draft Law on Postal Services” was presented to the public. It comprises 51 paragraphs and is intended to come into effect by the beginning of 1998 when the current legislation terminates. The Draft Law is subject to approval by the Bundesrat, which represents the 16 German states, and cannot be enacted by the Bundestag (Federal Parliament) alone. Since the Bundesrat and Bundestag are controlled by different political parties, political negotiation on the draft law is likely to emerge. Hence, the current version of the law may be subjected to changes. Major elements of the Draft Law are:

- i) Firms that want to deliver letters will have to meet licensing requirements. These requirements cover the market for letter delivery up to 2 KG weight. The Deutsche Post AG shall obtain an exclusive license for letters up to 0.35 KG. This monopoly terminates in 2002.

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<sup>13</sup> On the regulatory situation of the German postal system see also OECD, 1996, pp. 8.

- ii) The market for large-quantity letter freight up to 0.1 KG, which currently is reserved for the Deutsche Post AG, will be opened up to competition from 1998.
- iii) For services that are subject to licensing requirements, the Draft Law provides the possibility for government to define certain minimum standards (“Basisversorgung”). Some fund solution is planned in order to compensate for losses that might arise from financial burdens arising from meeting the minimum standards.
- iv) The current universal service obligation of the Deutsche Post AG on this market is not intended to be superseded by minimum standards as mentioned under (iii).

### ***United Kingdom***

Since 1969 the Post Office of the United Kingdom operates as a Crown corporation. It consists of three branches, namely the Royal Mail, Parcelforce, and Post Office Counters. Royal Mail operates mainly on the market for letters up to £ 1, and has the exclusive right for delivering such mail. A breakdown of turnover figures underlines the economic significance of that monopoly: More than 70 % of the Post Office’s total revenues are earned by the Royal Mail. Parcelforce is supplying the market for shipments of more than £ 1 postage. It operates without the protection of a monopoly regime and is thus exposed to competition from private parcel delivery services. Nevertheless, Parcel Force is obliged to provide universal service, which comprises the compulsion to contract at a nation-wide uniform price. With a market share of 25 % (1993/94) Parcelforce is the largest supplier of parcel delivery services in the United Kingdom (OFFICE OF FAIR TRADING, 1996, p. 10).<sup>14</sup>

The Post Office of the United Kingdom is state-owned and supervised by government. The regulatory body in charge of controlling the System is the Department of Trade and Industry. Despite the efficiency losses that normally are associated with public ownership, the Post Office is run on a commercial basis and operates profitably. Nevertheless, the profits and loss accounts of the three branches are fairly different. In the financial year 1994/95 Royal Mail and Post Office Counters achieved a surplus of £ 302 Mio and £ 23 Mio, respectively. Parcelforce, however, realised a deficit of £ 19 Mio. These figures indicate a practice of internal-subsidisation from the reserved area into competitive operations. Nevertheless, the scope of that cross-subsidisation seems to be fairly low. According to the 1994/95 figures given above, the share of Parceforce’s losses in the accumulated profits of Royal Mail accounts for some 5,9 %. In financial year 1993/94 this ratio took a value of 7,7 %.

As is the case in most countries, production of postal services in the United Kingdom is a labour intensive business. In 1995 the Post Office’s share of staff costs in total operating costs accounted for 54 %. The most labour intensive branch of the system seems to be the Royal Mail which has a share of labour costs in total costs of 69 %. This result may be attributable to the relatively labour intensive part of door to door service which is of particular significance in letter delivery. Post Office Counters and Parcelforce have realised a share of labour cost in total costs of about 23 % and 47 %, respectively.

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<sup>14</sup> It should be noted that the market for parcel delivery in the United Kingdom is characterised by a large variety of suppliers: “In 1993, the number of companies advertising parcel services was estimated at approximately 4,000. Given that barriers to entry are low - all that is needed to set up a parcels operation is a vehicle and a telephone - there is a high turnover of firms at the bottom end of the market. In addition, many taxi firms, road haulers and air freight firms offer ancillary parcel services” (OFFICE OF FAIR TRADING, 1996, p. 1)

Privatisation of Parcelforce seems to be an issue of current interest: “It is likely that government will seek to privatise Parcelforce in the event of its re-election” (OFFICE OF FAIR TRADING, 1996, p. 1). Such a policy move would follow the recent privatisation of Red Star, which used to provide parcel transport service as a state-owned subsidiary of British Rail but now operates as a private entity. With an annual turnover of nearly £ 500 Mio and about 13,000 employees, a privatisation of Parcelforce might lead to government revenue of considerable extent from the sale. It remains open in which way regulation of the market for parcel delivery, in particular the universal service obligation, would be adjusted in case of privatisation.

### *United States*

The regulatory situation in the United States ensures a relatively strong position for the public sector as a supplier of postal services. As a state-owned corporation, the United States Postal Service operates under the protection of a statutory monopoly for letter delivery. However, a precise definition of “what constitutes a ‘letter’ for purpose of the statute is somewhat unclear, and is subject to the discretion of the postal service” (VITA, 1996, p. 7). Therefore, the United States Postal Service in principle is in the position to adjust its own monopoly area in accordance, for example, with changes in the competitive situation. The rationale put forward for justifying the monopoly regime is based on natural monopoly assumptions and on the need for financing losses from operations on markets where the public corporation is obliged to provide universal service. However, as has been explained already, the validity of these assumptions with respect to postal systems in principle can be doubted and is subject of controversial debate.

The United States Postal Service is obliged to provide universal service, for instance on the markets for parcel delivery and express mail. Since the regulatory framework does not provide any monopolistic protection on these markets, the public corporation is exposed to competition from private firms. There are indications that the public supplier might lose market share in the future. Competition on the market for parcel delivery has become fiercer, thereby imposing new challenges on the United States Postal Service.

The prices charged by the United States Postal Service are subject to regulation by the Postal Rate Commission,<sup>15</sup> and should in principle reflect the cost of service production. The control exercised by the Postal Rate Commission, however, does not seem to be really binding, because the decisions of that authority can be overridden by the postal system’s Board of Governors. The United States Postal Service thus seems to be well prepared for maintaining its position.

The regulatory framework to a large extent affects competition in favour of the public supplier. The possibilities for cross-subsidisation figure prominently in this respect. In the first place, the mix of monopoly rights and universal service obligations - as in most other countries - aims at providing possibilities for bailing out deficits in competitive areas via recourse to profits earned on monopolised markets. Moreover, the United States Postal Service to some extent seems to avoid an assignment of costs to specific output categories, and “classifies almost all fixed costs as ‘joint and common’ “ (VITA, 1996, p. 8). Identification of anti-competitive cross-subsidisation therefore is relatively difficult. Another advantage of the United States Postal Service is an exemption from paying income tax. However, the public supplier might also be faced with some disadvantages, in particular the obligation to transport its

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<sup>15</sup> The Postal Rate Commission consists of five members who are appointed by the President.

mail on United States flag carriers at prices determined by the Department of Transportation (VITA, 1996, p. 11).

A comparison of delivery prices on the United States market for postal services with prices in Europe shows that the rates for parcel and letter delivery in the United States are relatively low.<sup>16</sup> One should keep in mind that this outcome to a considerable extent probably can be attributed to the regulatory situation of air and road transport. In the seventies and eighties, deregulation initiatives on these markets were put into effect which helped to contain the cost for parcel transport.<sup>17</sup> Moreover, the relatively flexible structure of the United States labour market helps to reduce labour costs.

An additional factor that could serve as an explanation for the relatively low parcel rates in the States, might be the possibility for private firms to co-operate with the public system. "For example, Federal Express drop boxes are located in almost every major office building in the United States" (OECD, 1995a, p. 5). Such arrangements might not only increase the volume of private firms, but they may also raise the volume of business in the entire market.

### **Considerations for Regulatory Reform**

The above review of factors that exert an impact on parcel rates underlines the dominant role of regulation. The lack of market forces in postal services motivates various kinds of cost-raising inefficiencies. Against this background the following principles for deregulation of postal systems are presented:

- i)* Monopoly rights granted to the public sector must be reconsidered. The efficiency losses associated with the lack of competition on monopolised markets for letter and postcard delivery can be expected to disappear if these markets were fully opened up to competition.
- ii)* It might be considered useful to safeguard some kind of obligation to contract on certain markets. This, however, does not necessarily imply a uniform price regulation. Instead, a more cost-related and flexible pricing policy is desirable.
- iii)* An alternative mechanism that ensures compensation for the financial burdens that arise from the compulsion to contract on non-profitable shipments is constructed as follows. A fund which is built on contributions of the competitors could be established. In that case all firms that operate on the market had to provide a certain contribution to the fund (possibly related to turn-over), which is set up with the purpose of financially supporting the supplier that is obliged to provide universal service.
- iv)* Private ownership of the postal corporation would help to lower cost figures, because public employment legislation would no longer apply. Moreover, private profit interest would change the incentive structure towards a more performance related management style and wage setting procedures.

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<sup>16</sup> For example, in 1992 the prices for delivering standard letters were as follows: United Kingdom \$ 0.36, France \$ 0.42, Finland: \$ 0.53, Germany \$ 0.63, and United States \$ 0.24 (DICKE, GLISMANN, and HORN, 1995, p.3)

<sup>17</sup> Particularly, the Airline Deregulation Act (1978) and the Motor Carrier Act (1980).

- v) Specific factors that affect competition between firms in an asymmetric way, as for example the exemption from value added tax granted to the Deutsche Post AG, should be abolished.

### **Further Work**

The benefits to consumers that can be reaped from regulatory reform of postal systems can be expected to be significant. These benefits would consist of lower rates for postal services and a better quality of output. In principle it is possible to estimate the magnitude of price decreases and the increases of business volume that might be triggered by regulatory reform. As described in Section III, for this purpose information about the price elasticity of demand, scale economies, and economies of scope is necessary. Such information could be obtained by follow-up work which investigates the following issues:

- i)* The production function in parcel delivery. Information on this field would allow to estimate the extent of potential scale economies, or in other words, the cost and price decreases that are feasible in the presence of increasing business volume.
- ii)* The price elasticity of demand in parcel delivery. This expectedly negative elasticity allows to estimate the increase of business volume that results from falling parcel rates.
- iii)* The extent of potential economies of scope that could be reaped from joint delivery of letters, postcards, and parcels. This would allow assessment of the effects of abolishing the postal monopoly in letter delivery which still exists in most OECD countries.

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