

Chapter 4

Anticompetitive Behavior in Postal Services

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Anticompetitive behavior by government postal services is of particular interest for a number of reasons, including the following. First, postal services are a major industry in terms of both sales and employment throughout the world. Second, historically there has been considerable government involvement in almost every country's post. Most postal services are, or were at one time, government-owned monopolies. Third, many postal services perform a core, monopolized activity of letter delivery but face competition either on the fringes of their core activity or in other noncore activities, such as parcel and express mail delivery. Fourth, there has been extensive reform of many postal services around the world, which has led to increased commercialization and resulted in additional competition between government and private firms.¹

In this chapter, I examine anticompetitive behavior by SOEs in the postal sector, both in the United States and internationally. Anticompetitive SOE behavior may lead to inefficient competition

between government and private firms. Inefficient competition occurs when a higher-cost (less efficient) firm is able to use government-granted privileges and immunities rather than superior business skills, to drive a lower-cost (more efficient) firm from the market, deter its entry, or reduce its market share.²

I first examine the case of the U.S. Postal Service (USPS). I briefly review the special government-granted privileges, subsidies, and immunities enjoyed by the USPS. This review provides a template for understanding government-granted benefits enjoyed by other posts and also suggests the importance of thoroughly examining institutional details.

Following that, I present data consistent with anticompetitive behavior by the U.S. Postal Service. Finally, I review examples of anticompetitive behavior that have arisen in postal services internationally.

Privileges Enjoyed by a Government Postal Service: The Case of the USPS

Commentators often focus on legally enforced monopoly as the main source of economic value (or rents) with which to subsidize competitive activities. However, the USPS receives a variety of additional special dispensations that artificially improve its ability to compete with private firms. Special privileges enjoyed by the USPS can be grouped into two categories: (1) monopoly and suspension powers and (2) a set of special privileges and immunities stemming from government ownership or sponsorship. I first discuss monopoly and suspension powers.

The USPS retains several key monopoly powers: a monopoly over letter delivery, a mailbox monopoly, and the ability to suspend the delivery monopoly in certain cases. The delivery monopoly is probably the government-granted privilege that raises the greatest fear. It is a concern because the USPS provides both monopolized services,

such as letter delivery, and competitive services, such as package and express mail, and can potentially use revenues from monopolized activities to cross subsidize competitive activities.

In the United States, the delivery monopoly is over letter mail. The Private Express Statutes prohibit the private carriage of “letters or packets,” and the Postal Service defines a letter as “a message directed to a specific person or address and recorded in or on a tangible object.”³ The courts have accepted the Postal Service’s broad test for a letter as, “the presence or absence of an address.”⁴

The USPS’s definition of a letter, adopted by the Postal Service in 1974, differs from earlier definitions and is much more expansive. Indeed, the Post Office and then the Postal Service has consistently expanded the scope of its monopoly over a 200-year period.⁵ Such an expansive definition leads naturally to monopolization of materials not intuitively considered letters, such as bills and advertising matter. According to the Postal Service’s definition, an addressed grocery store advertisement is a letter.

A substantial portion of USPS revenue comes from monopolized activities. In 2003, 56 percent of the Postal Service’s revenues from mail were from monopolized first-class mail, while more than 26 percent were from partially monopolized Standard Mail (formerly third-class mail).⁶

Additionally, the postal delivery monopoly in the United States differs critically from other utility monopolies in that its scope is effectively defined by the Postal Service itself. Scholars have noted that unusual institutional arrangement. Gregory Sidak and Daniel Spulber have stated, “The result is unlike that in any other regulated industry: Because the Postal Service claims for itself the term ‘letter,’ which defines the extent of its monopoly, the monopolist has the power largely to define the scope of its own monopoly.”⁷

The monopoly is well enforced. The USPS can conduct searches and seizures if it suspects citizens of contravening its monopoly. For example, in 1993, armed postal inspectors entered the headquarters of Equifax Inc. in Atlanta. The postal inspectors demanded to know

if all the mail sent by Equifax through Federal Express was indeed extremely urgent, as mandated by the Postal Service's criteria for suspension of the Private Express Statutes. Equifax paid the Postal Service a fine of \$30,000. The Postal Service reportedly collected \$521,000 for similar fines from 21 mailers between 1991 and 1994.⁸

The fact that the USPS holds a well-enforced letter delivery monopoly over which it effectively defines the scope is significant for anticompetitive behavior. Competitors or potential competitors are likely to be reticent about entering, investing in, or expanding activities in which they fear competition from the USPS. Were the delivery monopoly more circumscribed, rivals would be less fearful of the redistribution of monopoly rents toward competitive activities.

The USPS in fact holds two distinct monopolies. The second is a statutory monopoly over the use of private mailboxes. The Criminal Code stipulates a fine if matter on which postage has not been paid is deposited in a mailbox.⁹ The Postal Service's *Domestic Mail Manual* requires that mailboxes "shall be used exclusively for matter which bears postage."¹⁰ Additionally, the *Domestic Mail Manual* specifies the size, shape, and dimensions of mailboxes.¹¹

The United States is the only country that has a mailbox monopoly.¹² The Supreme Court, in *United States Postal Service v. Council of Greenburgh Civic Associations*, considered the constitutionality of the mailbox monopoly on free speech grounds. It came to the unsettling conclusion that postal customers must accept a monopoly over their own mailboxes in return for the privilege of being subjected to the Postal Service's monopoly over letter delivery. The court stated that "In effect, the postal customer, although he pays for the physical components of the 'authorized depository,' agrees to abide by the Postal Service's regulations in exchange for the Postal Service agreeing to deliver and pick up his mail."¹³

In addition to the delivery and mailbox monopolies, the USPS has the ability to selectively suspend the delivery monopoly in certain cases. Yale Law School professor George Priest has written, "In

the 1973 Report the Governors announce for the first time that they possess and that they will exercise the authority to suspend the private express statutes at their discretion. No Postmaster General has ever claimed the power to repeal or to ‘suspend’ the private express statutes by administrative order. But the Governors have discovered an obscure postal regulation which will allow them, with sympathetic interpretation, to surrender bits and pieces of their exclusive grant in ways to preserve the substance of the monopoly.”¹⁴ Exceptions include the obvious, such as letters accompanying cargo and letters of the carrier (which, for example, encompass interoffice correspondence), but also include letters by special messenger as well as extremely urgent letters. The latter two exemptions allow for bicycle messengers and overnight delivery services. Although suspension of the delivery monopoly has allowed numerous businesses, such as Federal Express and DHL, to develop and thrive, it remains unclear whether Congress ever gave the Postal Service legal authority to suspend the postal monopoly.¹⁵ Because it mitigates key potential opposition to the delivery monopoly, however, the ability to suspend the monopoly has been tolerated for decades.

The combination of an expansive definition of a letter, combined with the ability to selectively suspend the delivery monopoly, means that the USPS can effectively decide what falls under its monopoly. As James C. Miller observed, “Through its ability to define a ‘letter,’ the Postal Service is in the enviable position of being able to determine the extent of its own monopoly. While the service has ‘suspended’ its monopoly for certain letters (such as time-sensitive materials), it has also expanded its monopoly by defining letters to include bills, receipts, IBM cards, magnetic tapes, and other business documents. Typically, as new services such as express mail have developed, the Postal Service has first asserted that these services fall within its monopoly and then announced a suspension of the monopoly with respect to *some* aspects of the new service.”¹⁶

The implications for anticompetitive behavior of the delivery

and mailbox monopolies and the suspension ability are clear. The powers related to the postal monopoly are unlike those of other utility monopolies. The USPS is able to micromanage its monopoly power to garner the greatest economic rents while mitigating potential political opposition to the monopoly through the suspension power. Those shielded economic rents can be used to compete with private rivals not enjoying monopoly power.

The monopoly and suspension powers, however, are not the only government-granted privileges the USPS receives. There are a host of additional special USPS benefits, all of which can be used to artificially lower costs in activities where it faces competition.

It is exempt from taxation. Because it can borrow from the Federal Financing Bank, it enjoys an explicit government guarantee of its debt. It remains government owned and is thus exempt from paying investors an expected rate of return on their invested capital; that is, it benefits from captive equity.¹⁷ It is not subject to a bankruptcy constraint. It has, at various times, received direct cash subsidies. It has the power of eminent domain. It is exempt from a host of costly government regulations including antitrust law and SEC disclosure requirements. It is immune from parking tickets for its vehicles and from paying for vehicle registrations. It does not have to apply for building permits or conform to local zoning regulations, etc. All of the government-granted benefits enumerated above are valuable and allow the USPS to artificially reduce its prices below those of more efficient rivals.

USPS Pricing and the Postal Reorganization Act of 1970

The above discussion indicates that the USPS has the ability to use numerous government-granted privileges and immunities to subsidize activities in which it faces competition. David Sappington and Gregory Sidak's discussion in Chapter 1 of this book suggests it has that incentive. But is there any indication that it actually does?

The Postal Reorganization Act of 1970 allows a test of the hypothesis that, when given the opportunity, an SOE will reduce prices in competitive activities and raise them in monopolized activities. Although the act appears to have tightened some constraints on the USPS, it greatly reduced the intensity of congressional oversight of pricing. Before the act, Congress itself set postal rates with the assistance of the Bureau of the Budget. Although that arrangement resulted in prolonged and sometimes acrimonious debate over relative rates, it nevertheless vested final authority for price setting in Congress and constrained the Post Office.¹⁸

To regulate prices, the act created the Postal Rate Commission whose five members are appointed by the president with advice and consent of the Senate.¹⁹ The Postal Rate Commission was explicitly instructed to take the cost of providing specific classes of mail delivery into account in rate making through the requirement that “each class of mail or type of mail service bear direct and indirect costs attributable to that class or type plus that portion of all other costs of the Postal Service reasonably assignable to each class or type.”²⁰

That section of the act has been interpreted as an attempt by Congress to move away from using excessive first-class mail prices to subsidize other mail classes, which had been the case in the past. For example, the U.S. Court of Appeals for the District of Columbia Circuit in *National Association of Greeting Card Publishers v. United States Postal Service* stated that “Discrimination in postal ratemaking in favor of certain preferred classes of mail and to the great disadvantage of first class mail has long been part of our postal system. . . . In seeking postal reform through the 1970 Act it was a central and express aim of both Houses of Congress to end the abuses of this practice.”²¹

However, Congress did not provide the Postal Rate Commission with adequate authority to carry out its mandate of cost-based rates. First, the commission must consider at least seven other criteria besides attributable costs when determining rates.²² Second, the commission was not given authority to actually set postal rates, as

Congress had done, but merely to recommend rates to the USPS Board of Governors after a rate change request from the Postal Service.²³ A recommended change in a rate proposal is sent to the board for reconsideration, and the board can overrule the commission provided it is unanimous.²⁴ The board has twice used its authority to overrule the commission's recommended rates.

The third weakness is one of information, which has two dimensions. First, the commission lacks subpoena power. It must rely on testimony brought by participants in a rate hearing rather than demanding specific information from the USPS. Second, there are large information asymmetries between the Postal Service and all other parties.²⁵ This sometimes makes it difficult to obtain information relevant to avoiding cross subsidy.

Finally, the commission does not have the power to regulate the quality of postal services.²⁶ As an illustration, on July 25, 1990, the Postal Rate Commission formally advised the USPS of its opinion that it should not implement a plan to downgrade nationwide first class delivery standards.²⁷ On July 26, 1990, Postmaster General Anthony Frank responded in a letter stating that "After consideration of the opinion, we have concluded that it does not warrant changing our scheduled Saturday implementation of overnight standard changes. . . ." The Postal Service itself is thus able to determine critical variables, such as the number of deliveries per day or week and the speed of deliveries, giving it latitude for redistribution on that additional margin. Overall, the act effectively transferred control of Postal Service pricing from Congress to the USPS itself.²⁸ John Tierney has stated, "It hardly seems appropriate that a government agency enjoying a monopoly over certain of its services has the ultimate power to put into effect whatever rates it chooses."²⁹

That may be somewhat too strong because USPS pricing is not entirely unconstrained. The commission's decision does force the board to be unanimous in overruling it. Additionally, Congress exercises oversight through committee hearings, and the Senate has input into board memberships.

However, the above institutional changes imply that pricing controls on the USPS were substantially weakened by the act. Given those changes and the behavior postulated by Sappington and Sidak in Chapter 1, the USPS would likely have increased prices in monopolized (i.e., low elasticity) classes of mail and reduced prices where it faced competition (i.e., high elasticity) after the act.

Examining price changes before and after the act across various mail classes can test that prediction. The three largest classes of mail are first-class mail, third-class mail [now called standard mail (A)], and fourth-class mail [now called standard mail (B)].³⁰ First-class is generally considered the most monopolized class because it is composed primarily of letters subject to the delivery monopoly. Third-class mail is comprised mostly of bulk advertising matter. Fourth-class mail is primarily parcels and bound printed matter.³¹ Fourth-class mail faces intense competition from United Parcel Service, Roadway Package Service, and numerous trucking companies. Express mail, although small in terms of revenue, is also of interest because it faces considerable competition from private services including UPS Overnight and Federal Express. Express mail was not established as a separate class until October 9, 1977, so data prior to the act are not available.

Below, in figures 1 through 5, I show the real price—revenue per piece for each class—of first-class, fourth-class, and express mail over time. I also show the ratio of first class to fourth class and the ratio of first class to express mail.

Figure 1 displays the real price of first-class mail, the largest and most monopolized class. It indicates that a preact increase in first-class mail prices continued after the act was implemented in 1971 and that first-class prices leveled off around 1980. Figure 2 displays real fourth-class prices, which show a sustained downward trend after the act. The average real fourth-class price per piece was \$2.28 in 1971 and reached a low of \$1.21 in 1996, a decrease of 47 percent.

The final class of mail examined, express mail, is displayed in

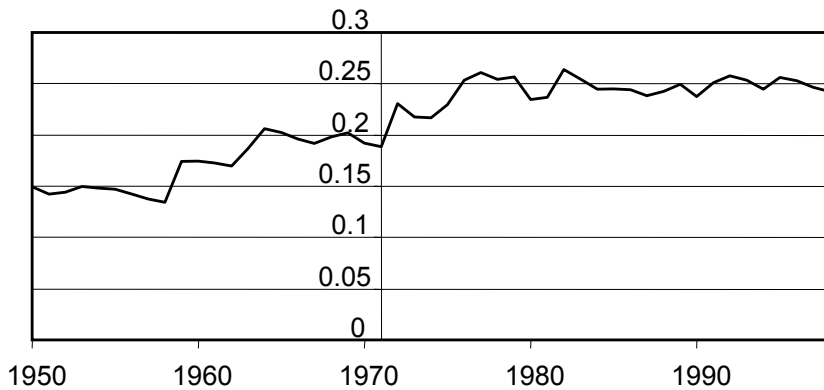


Figure 1. First-Class Mail Prices (1987 Dollars)

Figure 3. The act's effect on express mail prices cannot be examined explicitly because this mail class was created after the act's implementation in October 1977. Because this class faces intense competition, however, it is useful to examine its price behavior over time. Data for express mail prices from 1978 to the present show a pattern remarkably similar to the postact behavior of fourth-class mail. There was a decrease soon after inception, followed by a leveling off of prices.

Figure 4, showing the ratio of first- to fourth-class mail prices, is of particular interest. As expected, it displays a clear positive change

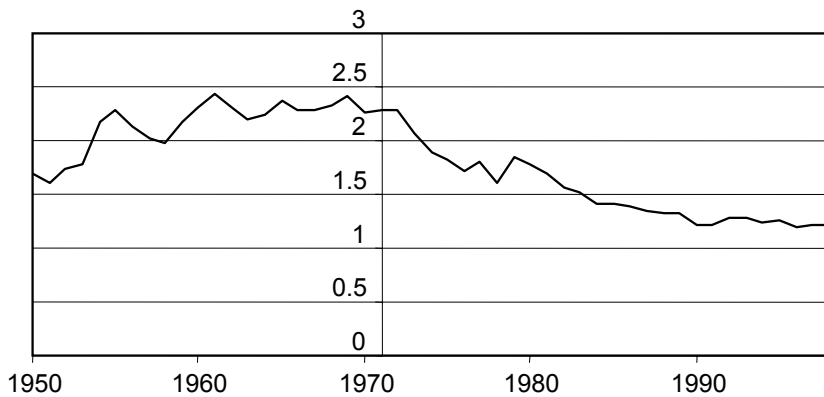


Figure 2. Fourth-Class Mail Prices (1987 Dollars)

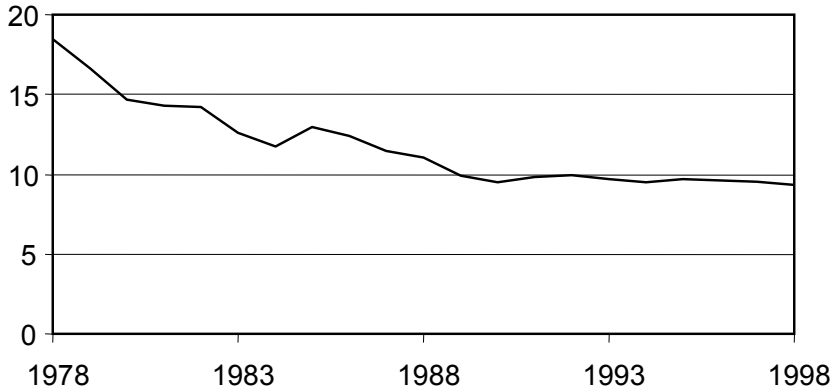


Figure 3. Real Express Mail Prices (1987 Dollars)

after the act was implemented in July 1971. There is no clear trend before the act. Figure 4 is also compelling because there are few alternative explanations with which it is consistent. As noted, court findings suggest that relative first-class prices were already too high before the act, so it is unlikely that Figure 4 reflects intentional adjustment of rates by the commission. First-class rates should have declined relative to other classes.

Moreover, it is unlikely that adjusting prices to cost would have taken 28 years were the commission endowed with sufficient power

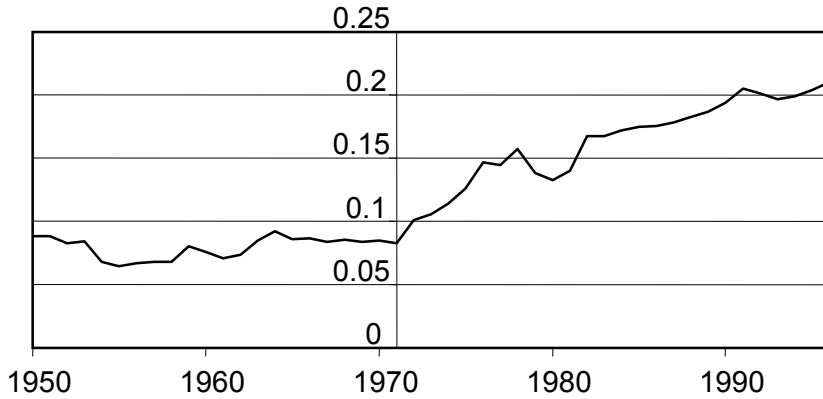


Figure 4. Ratio of First- to Fourth-Class Mail Prices

to control prices. Figure 4 is thus consistent with the USPS placing a greater burden on captive (low elasticity) customers relative to customers for whom they face competition; this is consistent with Sapington and Sidak's analysis. Referring to inverse elasticity pricing, postal scholar John Tierney noted, "Yet it appears that the Postal Service and the rate commission so far have done little to end the placing of an inappropriate share of the rate burden on first-class mail to cross-subsidize other classes. Although the appeals court disapproved of further use of the inverse elasticity rule, the Postal Service and the rate commission continue to implicitly apply it."³²

Figure 4 is more suggestive of the slow extraction of monopoly rents to increasingly subsidize competitive package delivery, subject to remaining political constraints, than of successful realignment of post-act rates. Additionally, Figure 1 shows that the upward trend in real first-class prices leveled off in the mid-1980s. This implies that the increase in the ratio since then is due to declining real fourth-class prices, as shown in Figure 2, which suggests a large degree of diversion of resources aimed at reducing fourth-class prices.

Although the technology of mail delivery has changed substantially during this period, technological improvement is likely to have favored delivery of first-class letter mail rather than fourth-class packages.³³ The ratio would have then fallen over time under pricing consistent with the cost-allocation mandate in the act. It is also unlikely that technological change would have caused such an abrupt shift in slope in 1971.

Supporting evidence is provided by the ratio of first-class to express mail prices as shown in Figure 5. The trend in that ratio is not as pronounced as that in Figure 4 and appears to have leveled off in recent years but, as expected, is still decidedly positive. Between 1978 and 1990 the ratio increased by more than 65 percent.³⁴

Figures 1 through 5 suggest that when the Postal Reorganization Act of 1970 reduced control over U.S. Postal Service pricing, it moved toward higher prices for monopolized relative to competitive mail classes. Data suggest that the act increased the ratio of first- to

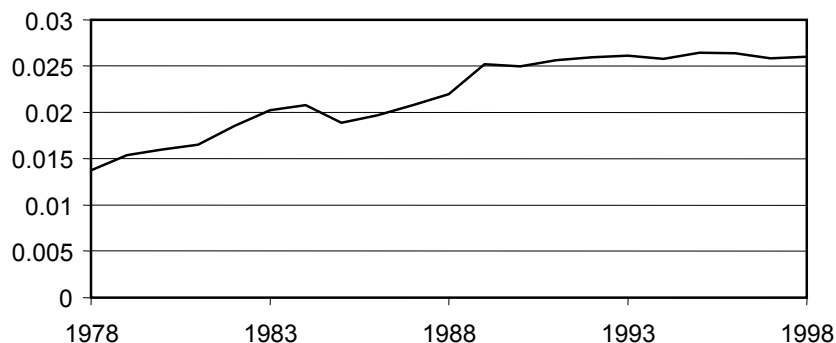


Figure 5. Ratio of First-Class to Express Mail Prices

fourth-class mail prices, and the ratio of first-class to express mail prices provides corroborative evidence.

Express mail and package delivery are not the only competitive activities into which the USPS has entered, however. The USPS has initiated many new activities outside its core area of delivering letters. It has expanded into selling mugs, T-shirts, phone cards, passport photos, and a variety of e-commerce services such as eBill Pay, NetPost Cardstore, and NetPost Certified Mail. It has done so without receiving the prior approval of the Postal Rate Commission.³⁵ The USPS has lost money on many of those services and in the process has weakened or driven private firms out of the market. The USPS is able to pass the losses from those services along to customers, who are captive to its delivery monopoly.

Although this chapter has presented only one test of the hypothesis, it is supportive of the conclusion that SOEs will cross subsidize activities where they face competition. Below, I review examples of anticompetitive behavior by postal services in other countries.

Examples of Anticompetitive Behavior in Postal Services in Other Countries

Given the extensive reforms in postal services that have been undertaken in other countries, it is not surprising that competition issues

have arisen. Here I review issues that have arisen in Germany, Sweden, and Belgium. This is not intended to be an exhaustive list of current competition issues but rather to illustrate the types of issues that have arisen in the postal sector.

There are a variety of pending competition cases and complaints in the postal sector.³⁶ In addition to those in Germany, there are complaints in Belgium, Finland, France, Greece, Iceland, Italy, The Netherlands, Norway, Portugal, Spain, and the United Kingdom. The German, Belgian, and Swedish cases were chosen because there are several issues concerning each post and because of the amount of information available about them.

Deutsche Post

The experience with the German post office, Deutsche Post World Net, illustrates several anticompetitive issues that may arise under reform. Deutsche Post became an aggressive competitor as a result of the extensive postal reforms in Germany, particularly partial privatization. Deutsche Post retained various benefits after privatization, importantly including a delivery monopoly over letters in Germany.

There are three specific examples of Deutsche Post engaging in behavior that is potentially anticompetitive. The first involves incoming international mail, specifically mail from the United Kingdom. The second concerns its acquisition campaign. The third concerns the pricing of competitive services, specifically its parcel delivery service.

In 1998, the British Post Office filed a complaint with the European Commission. It alleged that Deutsche Post had intercepted, surcharged, and then delayed international mail from the United Kingdom arriving in Germany.³⁷ The dispute stemmed from a disagreement between the British Post and Deutsche Post about how to identify the sender of international mail. Deutsche Post asserted that all incoming international mail that had a reference to Germany

(usually in the form of a German reply address) should be considered to have a German sender, irrespective of where the mail was produced or posted. Under the theory that such mail was circumvented domestic mail, Deutsche Post refused to deliver those letters unless the full domestic tariff applicable in Germany was paid. Delays of up to several weeks were common.

The European Commission investigated the issue and concluded that the mail did not have German senders. Instead, the mail was produced in Holland or Sweden or in the United Kingdom and was posted to Germany via the United Kingdom. The commission then initiated separate proceedings against Deutsche Post for abuse of its dominant position, on the grounds that it had interrupted the international flow of mail. The commission accused Deutsche Post of infringing upon the competition rules of the European Union by intercepting incoming cross-border mail, imposing surcharges, and delaying delivery. On July 25, 2001, the commission decided that Deutsche Post had abused its dominant position: “The Commission has adopted a decision pursuant to Article 82 of the EC Treaty finding that Deutsche Post has abused its dominant position on the German letter post market by intercepting, surcharging and delaying incoming international post which it erroneously classes as circumvented domestic mail (or ‘A-B-A remail’). Deutsche Post’s improper conduct warrants the imposition of a fine. However, in view of legal uncertainty at the time the infringement was committed, the Commission has decided to impose only a ‘symbolic’ fine of EU 1,000 on Deutsche Post.”³⁸ The press release provides more detail: “The Commission found that Deutsche Post abused its dominant position in the German market for the delivery of international mail—thereby infringing Article 82 of the EC Treaty—in four ways. Deutsche Post *discriminated* between different customers and *refused to supply* its delivery service unless an unjustified surcharge was paid. The *price* charged for the service was *excessive* and the behaviour of Deutsche Post *limited the development* of the German market for the

delivery of international mail and of the UK market for international mail bound for Germany.”³⁹ Although the injured party in this case was another postal system, the episode suggests that a monopoly, partially government-owned firm will engage in anticompetitive behavior.

Deutsche Post has also embarked on an extensive campaign of mergers and acquisitions, including purchase of DHL, ASG, Danzas, Securicor, and Trans-o-Flex, among others. When Deutsche Post acquired a minority stake in DHL in 1998, competitors expressed concerns about that acquisition.

The European Commission was hopeful that requiring Deutsche Post to keep separate accounts and not discriminate against competitors would prevent it from doing so, stating,

During the Commission’s investigation, competitors expressed concern that Deutsche Post would be able to cross-subsidize DHL from its monopoly on postal services (i.e. for letters below a set weight and price) and to discriminate against competitors wishing to use Deutsche Post’s network. Deutsche Post has therefore undertaken to refrain from cross-subsidizing DHL from its postal monopoly, to keep and publish separate accounts for its monopoly and non-monopoly activities, and not to discriminate against competitors. Publication of separate accounts will enable interested parties to ascertain whether Deutsche Post is fulfilling its undertakings. The Commission will also keep a close watch on Deutsche Post to ensure that these undertakings are being strictly complied with.⁴⁰

With regard to its acquisition of ASG, competitors raised a different issue: that of utilization of government-granted economic rents to inefficiently acquire companies.⁴¹ Deutsche Post also acquired Air Express International, a U.S. freight forwarder. Competitors were again concerned that Deutsche Post would use revenues from its mail delivery monopoly to undertake anticompetitive activities in the freight forwarding business.⁴²

The European Commission found that concerns about those acquisitions were valid. It decided to initiate proceedings under Article 6(1)(c) of the merger control regulation on March 4, 1999.⁴³ The Bulletin states that “The Commission has serious doubts as to the compatibility of this planned acquisition with the common market since its investigations show that Trans-o-Flex has a significant presence in areas where Deutsche Post already has substantial market shares.” The European Commission also found that Deutsche Post was cross subsidizing a number of foreign and domestic acquisitions with rents from its monopoly.

Despite those findings, in March 2000 the Court of First Instance found that the European Commission had failed to act sufficiently in response to a number of complaints regarding Deutsche Post.⁴⁴ The commission then undertook more formal proceedings. It focused on Deutsche Post’s pricing of parcel delivery services for mail-order business. It found that, consistent with the concerns of competitors, Deutsche Post was indeed cross subsidizing parcel services. It was doing so by providing mail-order traders with significant discounts, known as fidelity rebates, if they would give all (or almost all) of their business to Deutsche Post. The commission found that Deutsche Post did not come close to covering its costs for mail-order parcel services but was instead using monopoly rents to subsidize certain services. It also found that Deutsche Post was charging its first-class customers an excessive amount to maintain the cross subsidy.

The commission concluded that Deutsche Post had abused its dominant position by granting rebates and by engaging in predatory pricing in the market for business parcel services.⁴⁵ Deutsche Post was then required to create for its business parcel service a separate legal entity (called Newco), with a system of transparent and market-based pricing between Deutsche Post and the new entity. The commission found that such a system would be a suitable safeguard against cross subsidy from Deutsche Post’s monopoly. Deutsche Post

was also fined for its behavior. In its press release, the European Commission stated that

The European Commission has concluded its antitrust investigation into Deutsche Post AG (DPAG) with a decision finding that the German postal operator has abused its dominant position by granting fidelity rebates and engaging in predatory pricing in the market for business parcel services. As a result of the investigation, DPAG will create a separate legal entity for business parcel services. The system of transparent and market-based pricing between DPAG and the new entity for products and services they might provide to one another is a suitable safeguard for DPAG's competitors in business parcel deliveries that revenues from the monopoly in the letter market will not be used to finance such services. Furthermore, in light of the foreclosure that resulted from a long-standing scheme of fidelity rebates granted by DPAG to all major customers in the mail-order business, the Commission has imposed a fine of €24 million. This is the first formal Commission decision in the postal sector under Article 82 of the EC Treaty which prohibits abuses of a dominant position.⁴⁶

This case is important not only for its large fine and the application of competition law to the postal sector but also for its solution: the separation of business entities and the requirement of market-based pricing.

Taken together, these examples suggest that Deutsche Post's conduct is a serious and legitimate concern for competition authorities. The tactics of an entirely government-owned postal service, Sweden Post, suggest that such anticompetitive concerns are not limited to private or partially private firms.

Sweden Post

Postal services in Sweden were deregulated on January 1, 1993. Sweden Post's legal monopoly effectively ended on that date. However,

Sweden Post maintained a de facto monopoly because its share of the postal market remained between 85 and 100 percent. Moreover, Sweden Post remained 100 percent government owned. Because of its government-owned status and its previous legally enforced monopoly, Sweden Post enjoyed substantial advantages over new entrants. Those advantages gave rise to several cases of anticompetitive behavior.

Privak was a new firm that entered the mail order distribution business in Sweden. It thus competed directly with Sweden Post. In response to that entry, Sweden Post entered into exclusive agreements, with customers obliging them to buy most or all of their mail-order distribution services from Sweden Post.⁴⁷ Sweden Post also offered various rebates and sales target arrangements that had the effect of creating loyalty to Sweden Post. The arrangements effectively excluded Privak from the market. It was found that those tactics inefficiently enhanced Sweden Post's market position and constituted an abuse of dominant position.⁴⁸

Sweden Post also faced competition from CityMail and from Svensk Direkreklam AB. Competition was most intense in Stockholm, but CityMail also expanded into Malmo and Gothenburg. Sweden Post used an array of anticompetitive arrangements to maintain market share in the face of that competition. Those devices were designed to prevent the loss of customers to the new entrants.

The main instrument Sweden Post used to fend off competition was the geographic price differential.⁴⁹ That tactic allowed Sweden Post to set substantially lower prices in areas where it faced competition (that is, where elasticity of demand was high). For example, in Stockholm, where Sweden Post faced intense competition from CityMail, its price was about 30 percent lower than in other areas.⁵⁰

Sweden Post, however, utilized a system of discounts and rebates that reduced the price even further. It constructed volume discounts that were specifically designed to confront competition from CityMail. When CityMail expanded into Malmo and Gothenburg, Swe-

den Post extended its Stockholm pricing system into those cities. It used tie-in agreements, exclusivity clauses, discriminatory discounts, and other strategies that were quickly condemned by the Swedish Competition Authority.⁵¹ Despite legal condemnation, CityMail was driven into bankruptcy and was taken over by Sweden Post.

SDR competes with Sweden Post in the distribution of unaddressed letters within Sweden. It does not operate in rural areas, however, and had to rely on Sweden Post to distribute letters in those areas. SDR was thus in the unusual position of being both a competitor and a customer of Sweden Post.

The Swedish Competition Authority examined the situation and found that the price Sweden Post charged for distribution in rural areas was dependent on whether the customer in question also used Sweden Post for urban distribution.⁵² As a result, SDR paid much more for its rural delivery service. The Swedish Competition Authority found the practice to be a violation of the Swedish Competition Act.

Belgian Post (De Post - La Poste)

Hays plc., a United Kingdom-based private postal operator, competes with the Belgian postal operator De Post - La Poste in providing business-to-business (B2B) mail services to insurance companies in Belgium. Hays has provided those services since 1982.

Hays filed a complaint with the European Commission against La Poste in April 2000 contending that La Poste was trying to eliminate its document exchange network by linking rate reductions in monopolized services to subscribership to La Poste's new B2B service.⁵³

The commission investigated and found that the preferential tariffs Hays's insurance customers had enjoyed in sending general letter mail were unilaterally terminated by La Poste when those companies indicated they were not interested in the new B2B service

offered by La Poste.⁵⁴ Moreover, La Poste allowed the termination of preferential rates to stand until the insurance companies subscribed to its B2B service, which they did on January 27, 2000.⁵⁵ The commission found that this misuse of La Poste's monopoly power made it impossible for Hays to compete on a level playing field with La Poste.

After a new management team was installed at La Poste, the company cooperated with the commission. It voluntarily abolished its practice by discontinuing its B2B mail service on June 27, 2001. The episode nevertheless illustrates the tendency of an SOE to behave in an anticompetitive manner.

Joint Ventures Involving European Posts

As noted earlier, there have been several joint ventures involving European posts. For example, Post Denmark, Finland Post, Norway Post, and Sweden Post created a joint venture in the express delivery market called Vasagatan 11 International AB. Joint ventures fall under competition regulations adopted by the European Commission. There are two basic provisions under which postal joint ventures may fall. They are Article 85(1) and 85(3) of the EC Treaty and the Merger Regulation. The Merger Regulation applies, in part, to any full-function joint venture with a community dimension. A joint venture is full-functioning if it has the required resources to perform, on a continuing basis, all the functions of an independent company.

Competition authorities have taken several steps to ensure that Vasagatan will not be inefficiently subsidized, and there are several elements of Vasagatan's organization that are relevant for policing anticompetitive behavior. First, Vasagatan will not engage in any services that are considered to fall under the posts' universal service obligations. Second, Vasagatan will be a stand-alone operation. That is, Vasagatan will operate at arm's length from its parents and will be

free to subcontract with third parties to carry out deliveries but will have nonexclusive agreements with the posts for sales, marketing, and pick-up and delivery services.⁵⁶

Summary and Conclusions

Private rivals do not enjoy the numerous benefits of government posts, which may include a monopoly in the reserved area of service, tax benefits, government-subsidized debt, freedom from paying equity investors an expected rate of return, exemption from social regulation, and other benefits. Because money is fungible, those privileges and immunities can be used to inefficiently compete with unsubsidized entrants. Inefficient competition occurs when a less efficient firm is able to use government-granted advantages, rather than superior business skills, to drive a more efficient firm from the market, deter its entry, or reduce its market share.

This chapter suggests that government postal firms have used a wide variety of tactics to inefficiently compete with rivals. These include fidelity rebates, distortionary pricing, interception of incoming international mail, discriminatory discounts, and others. Data on the U.S. Postal Service's reaction to the 1970 Postal Reorganization Act is also consistent with a government post behaving in an anti-competitive manner.

Various policies that have been used to address such anti-competitive behavior include the divestiture of competitive from monopolistic activities, accounting separation of competitive and monopolistic activities, creation of clear, market-based pricing for different business units, and the requirement that joint ventures function as stand-alone operations to avoid cross subsidies to competitive operations.

The examples of Deutsche Post and Sweden Post indicate that competition authorities must be resolute when confronting anti-competitive behavior by a government postal firm. In the case of both

CityMail and Deutsche Post's pricing of parcel delivery services, initial legal responses were inadequate to deter anticompetitive behavior.

A case currently before the Supreme Court, *United States Postal Service v. Flamingo Industries*, will determine whether or not the U.S. Postal Service is subject to the antitrust laws. Regardless of the decision in that case, the analysis in this chapter suggests that explicitly subjecting the USPS to the antitrust laws is an appropriate policy change.

Notes

1. For an overview of international postal reform, see Chapter 6 in Rick Geddes, *Saving the Mail: How to Solve the Problems of the U.S. Postal Service* (Washington, D.C.: AEI Press, 2003).
2. See Chapter 2 in this volume for a more detailed discussion of inefficient competition.
3. 39 C.F.R. § 310.1(a). In Europe, the delivery monopoly is more circumscribed, and Sweden, Finland, and New Zealand have completely eliminated their postal monopolies.
4. *Associated Third Class Mail Users v. United States Postal Service*, 600 F.2d 824, (830 D.C. Cir. 1979) (Wright, J.).
5. See James I. Campbell Jr., "The Postal Monopoly Law: A Historical Perspective," in *The Last Monopoly: Privatizing the Postal Service for the Information Age*, ed. Edward L. Hudgins (Washington, D.C.: Cato Institute, 1996), 18.
6. *U.S. Postal Service, 2002 Annual Report*. For a detailed discussion of the extent of the postal monopoly, see J. Gregory Sidak and Daniel F. Spulber, "The Nature and Extent of the Postal Monopoly," Chapter 2 in *Protecting Competition from the Postal Monopoly* (Washington, D.C.: AEI Press, 1996). The monopoly power is a frequent topic of policy discussion. See, for example, Douglas K. Adie, *Monopoly Mail: Privatizing the U.S. Postal Service* (New Brunswick, N.J.: Transaction Publishers, 1989); Peter J. Ferrara, *Free the Mail: Ending the Postal Monopoly* (Washington, D.C.: Cato Institute, 1990); Edward L. Hudgins, *The Last Monopoly: Privatizing the Postal Service for the Information*

- Age* (Washington, D.C.: Cato Institute, 1996); and James C. Miller III, "End the Postal Monopoly," *Cato Journal* 5, no. 1 (1985): 149–56.
7. Sidak and Spulber, *Protecting Competition*, 12.
 8. Sidak and Spulber, *Protecting Competition*, 31–32.
 9. 18 U.S.C. § 1725.
 10. *Domestic Mail Manual* § 151.2. There are no efficiency or equity arguments for the mailbox monopoly. Clearly, this monopoly is designed to preserve revenues, or economic rents, which can be used in anticompetitive ways.
 11. Sidak and Spulber, *Protecting Competition*, 34.
 12. Robert H. Cohen et al, "An Analysis of the Potential for Cream Skimming in the U.S. Residential Delivery Market," in *Emerging Competition in Postal and Delivery Services*, ed. Michael A. Crew and Paul R. Kleindorfer (Boston: Kluwer Academic Publishers, 1999), 143.
 13. 453 U.S. (1981) at 128. See Sidak and Spulber, *Protecting Competition*, 35–37, for a detailed discussion of the case.
 14. George L. Priest, "The History of the Postal Monopoly in the United States," *Journal of Law & Economics* 18 (1975): 79.
 15. James I. Campbell Jr., in *An Introduction to the History of the Postal Monopoly Law in the United States*, mimeo, 27 June 1995, 29, wrote, "To mitigate opposition to its new definition of *letter*, the Postal Service also issued regulations which purported to 'suspend' the postal monopoly. These 'suspensions' created administrative exceptions from the postal monopoly for newspapers, magazines, checks (when sent between banks), data processing materials (under certain circumstances), urgent letters, international remail, etc. While the suspensions have prevented politically powerful mailers from petitioning for Congressional review of the postal monopoly, it appears clear that, as a matter of law, Congress has never authorized the Postal Service to suspend the postal monopoly. As statutory authority for these suspensions, the Postal Service cites an 1864 postal act. However, it is apparent from even a superficial reading of the legislative history of the act that this provision was never intended to confer authority to suspend the postal monopoly."
 16. Miller III, "End the Postal Monopoly," 150. (In note 6 above.)
 17. See Chapter 2 in this volume for a more detailed discussion of this concept.
 18. John. T. Tierney, *Postal Reorganization: Managing the Public's Business*

- (Boston: Auburn House, 1981), 104–7, provides a detailed description of the debate surrounding rate setting prior to reorganization.
19. 39 U.S.C. § 3601, 3624 (1970).
 20. 39 U.S.C. § 3622 (b) (3).
 21. *National Association of Greeting Card Publishers v. United States Postal Service*, 569 F.2d 570 (D.C. Cir. 1976).
 22. These include a fair and equitable schedule, the value of the mail service actually provided, the effect of the rate increase upon the general public, and the simplicity of the structure, among others. See Tierney, *Postal Reorganization*, 111.
 23. 39 U.S.C. § 3661 (b).
 24. 39 U.S.C. § 3625 (a),(d).
 25. Tierney, in *Postal Reorganization*, 115, states, “Though mail users and competitive delivery systems are investing huge sums of money in acquiring their own information and expertise, they find themselves at a disadvantage in facing the relatively information-rich Postal Service.”
 26. Letter of the Postmaster General to the Chairman of the Postal Rate Commission, 26 July 1990. Copy on file with the author. See also Sidak and Spulber, *Protecting Competition*, 50.
 27. “Summary of Postal Rate Commission Advisory Opinion on First-Class Delivery Standards Realignment,” N89-1, 25 July 1990. Copy on file with the author.
 28. Scholars have noted this change. For example, see Sharon M. Oster, “The Failure of Postal Reform,” in *Deregulation and Privatization in the United States, Hume Papers on Public Policy* 3, ed. Paul W. MacAvoy (Edinburgh: Edinburgh University Press, 1995), 114–15, who states, “In sum, the Act replaced the overly-meddlesome, highly politicized oversight of the postal organization by Congress with oversight by a board which is under almost no control at all, coupled with sporadic Congressional inquiry when particular interests are threatened!”
 29. Tierney, *Postal Reorganization*, 210. Similarly, Sidak and Spulber, *Protecting Competition*, 100, stated, “Unfortunately, the current forms of public control of the Postal Service are ineffectual. In essence, the Postal Service is an unregulated monopolist that is constrained only in the sense that it is expedient for the enterprise not to show a profit.”
 30. The USPS instituted a new mail classification system in 1996. See *United States Postal Service, 1996 Annual Report*, 39–41.
 31. *1996 Annual Report of the United States Postal Service*, 40–41.

32. Tierney, *Postal Reorganization*, 130.
33. Important advances have been in optical character recognition and sorting technology for letters, but packages must still frequently be physically handled. See Rick Geddes, "Technological Change and the Case for Government Intervention in Postal Service," in *The Half-Life of Policy Rationales: How New Technology Affects Old Policy Issues*, ed. Fred E. Foldvary and Daniel B. Klein (New York: New York University Press, 2003), 211–12.
34. Others have recognized the USPS subsidy to overnight services: "One widely recognized instance of charging different prices based upon the elasticity of demand is where the postal service has been charging a monopoly price for first class mail and then using the proceeds to subsidize the provision of overnight mail delivery which they suffer losses on. The recent increase in first class rates to 25 cents coincided with a simultaneous reduction in the government postal service's domestic overnight express mail charges to \$8.75, despite the fact that the express mail service was already losing money at the higher price." John R. Lott Jr., "Predation by Public Enterprises," *Journal of Public Economics* 43 (1990), 246.
35. See *Petition of Consumer Action Requesting that the Commission Institute Proceedings to (1) Review the Jurisdictional Status of Fourteen Specified Services and (2) Establish Rules to Require a Full Accounting of the Costs and Revenues of Non-Jurisdictional Domestic Services*, Petition for Review of Unclassified Services, Before the Postal Rate Commission (15 October 2002).
36. See, for example, <http://www.freefairpost.com/others/pending.htm> (visited 25 April 2002).
37. "Commission Condemns Deutsche Post AG for Intercepting, Surcharging and Delaying Incoming International Mail," DN: IP/01/1068, 25 July 2001 (European Commission Press Release).
38. Bulletin EU 7/8-2001 (en): 1.3.44.
39. "Commission Condemns Deutsche Post AG for Intercepting, Surcharging and Delaying Incoming International Mail," DN: IP/01/1068, 25 July 2001 (European Commission Press Release). Emphasis in original.
40. See Bulletin EU 6-1998 (en): 1.3.48, available at <http://europa.eu.int/abc/doc/off/bull/en/9806/p103048.htm>.
41. The commission stated, "In the course of its investigation, the Com-

- mission has, as in previous cases, received many complaints from private-sector competitors. They claim that Deutsche Post has financed its acquisitions with funds that have not been earned on the market, thus creating distortion of competition. The Commission will look into these problems in the light of the rules on State aid and public undertakings.” Bulletin EU 7/8-1999 (en): 1.3.31.
42. Bulletin EU 1/2-2000 (en): 1.3.76.
 43. See Bulletin EU 3-1999 (en): 1.3.32.
 44. “Commission Initiates Proceedings Against Deutsche Post AG for Abuse of a Dominant Position,” IP/00/919, Brussels, 8 August 2000.
 45. “Antitrust Proceedings in the Postal Sector Result in Deutsche Post Separating Competitive Parcel Services from Letter Monopoly,” IP01/419, European Commission, Brussels, 29 March 2001.
 46. DN: IP/01/419, 20 March 2001 (European Commission Press Release).
 47. Swedish Competition Authority, “Abuse of Dominance and Monopolization,” OCDE/GD (96)131, Competition Policy Roundtables, Number 8, obtained from <http://www1.oecd.org/daf/clp/Roundtables/abs13.htm> (visited 9 February 2002).
 48. Ibid.
 49. See Erik Nerep, “Current Competition Law Issues in Regard to the De-(Re-) Regulation of the Swedish Postal Services Market—Especially the Problems of Defining the Relevant Market, and Establishing Price Discrimination and Predatory Pricing,” Research Report, Stockholm School of Economics, October 1996.
 50. Ibid., 4.
 51. See James I. Campbell Jr., “The Global Postal Reform Movement,” in *Mail @ the Millennium* (Washington, D.C.: Cato Institute, 2000), 172. Also see Swedish Competition Authority, “Abuse of Dominance and Monopolization,” OCDE/GD(96)131, Competition Policy Roundtables, Number 8, obtained from <http://www1.oecd.org/daf/clp/Roundtables/abs13.htm> (visited 9 February 2002), which states that the Swedish Competition Authority found this to be an abuse of dominant position.
 52. Swedish Competition Authority, “Abuse of Dominance.” (In note 51 above.)
 53. “Antitrust Decision Against De Poste - La Poste Aims to Protect Competitive Postal Service from the Monopoly,” EU Institutions Press Release (DN: IP/01/1738) 5 December 2001.

54. Ibid.
55. La Poste notified the insurance companies of the termination on 30 October 1998.
56. See Leskinen, Pekka, and Kent Karlsson, "Postal Joint Ventures and EC Competition Law Considerations: A Case Study Based on a Venture Between the Nordic PPOs," in *Emerging Competition in Postal and Delivery Services*, ed. Michael A Crew and Paul R. Kleindorfer (Boston: Kluwer Academic Publishers, 1999), 44.