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A Broad Economic Analysis of the Effects of Liberalising the Postal Market

Documentation and considerations for the Swedish Postal and Cashier Service Commission

Björn Falkenhall and Anne Kolmodin

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Foreword

The decision to deregulate the postal market was preceded by several studies of the new conditions likely to prevail within the EU, and the market changes expected. The deregulation of the postal market meant that on 1 January 1993 the mail monopoly previously enjoyed by the Swedish Post Office (currently known as *Posten Sverige AB*) ended. The deregulation of the Swedish mail market is unique because, even today, only a few countries have implemented a comprehensive liberalisation. The way the Swedish mail market has developed in the past ten years therefore constitutes one of the few empirical examples of this process in the world.

In the spring of 2004, the Postal and Cashier Service Commission requested that the Swedish Institute of Growth Policy Studies (ITPS) conduct a broad economic analysis of the deregulation or liberalisation of the postal market.

Björn Falkenhall (Project Manager) and Anne Kolmodin worked with the economic analysis, with Eva Ohlin at the ITPS Washington office writing Section 4 on the U.S. Postal Service. The report was submitted to the Postal and Cashier Service Commission on 15 September 2004, and has served as documentation for the government commission report, SOU 2005:5 *Postmarknad i förändring* (The Changing Postal Market). Only parts of the present report, however, appear in the government report, which was sent out for comments during the spring of 2005. The report therefore concludes with the comments of ITPS regarding the proposal.

Östersund, August 2005

Sture Öberg
Director-General

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1 Introduction

In the spring of 2004, the Postal and Cashier Service Commission requested that the Swedish Institute of Growth Policy Studies (ITPS) conduct a broad economic analysis of the deregulation or liberalisation of the postal market. The deregulation of the postal market meant that on 1 January 1993 the mail monopoly previously enjoyed by the Swedish Post Office (currently known as *Posten Sverige AB*) ended. The concept of deregulation or liberalisation, however, is misleading, as the amount of regulation is actually on the increase. This is in no way limited to the postal market, but also applies to other deregulated markets. Thus, it is more of a transition from a partially regulated monopoly to a market with regulated competition. When a new market emerges, regulations are needed to create a competitive system for tasks such as supplying service providers with necessary infrastructure such as postal codes and post office boxes, as well as for ensuring that general objectives of the Postal Services Act are satisfied. As the market develops, there is normally less need for regulation. Regulatory systems must also be designed to change as a result of technical development or changes in customer behaviour, for example.

The challenge is to fashion a law that will balance the need for regulation with the independence of the market. In other words, the market should be supported but not disturbed. However, it is no easy task to design regulations that achieve this objective without simultaneously causing undesirable effects. The main function of the new rules must be to protect the social economic gains that the original deregulation strove to achieve.

1.1 Project

The project assigned to us was to conduct a broad economic analysis of the postal market. The project includes:

- Evaluating the effects of the 1993/1994 deregulation on the postal market, with a focus on:
 - Price levels
 - Accessibility
 - Level of service
 - Development of new services and innovations
 - Entry of new companies onto the market
 - Profitability for the parties involved on the market
 - Demand from various customer categories (e.g. private individuals and businesses)
- Evaluating the effects of the deregulation from both a producer and a consumer perspective
- Evaluating the effects of the deregulation from a regional perspective.

- Making comparisons between the postal policy objective and the actual result of the liberalisation, based on the level of ambition established by the Government and Parliament and how this has been carried out.
- Identifying and analysing any possible obstacles to increased competition within all or parts of the postal sector.

1.2 Method and definitions

The contrafactual state or the problem of "what if"

The most important problem in all evaluations of policy measures is called the "*what if*" problem. In other words, "What would have happened if a policy measure had not been taken?" It is impossible to know how good or bad things would have worked, or what the situation would have been like, if the Post Office still had a monopoly on the postal market. Although we can assume that events would have developed in a given direction due to the prevailing market situation, this remains an assumption however, and no one can know what would have happened. One common mistake made in evaluations is ascribing every positive or negative circumstance that occurs following a political measure to that measure.¹

Evaluating the effects of deregulation is difficult, and requires a decision as to which standard to use. One possible standard is the officially stated goals of deregulation, whilst another is social-economic efficiency. As it is difficult to measure actual social-economic efficiency, price, cost or productivity trends are often used as evaluation criteria.² This report uses a combination of these two standards (i.e. the achievement of postal policy goals and social economic efficiency in the form of price trends, cost adjustments and productivity trends). Other aspects, such as the consequences of cutbacks on employees, on the other hand, are not dealt with. Finally, as mentioned initially, actual events must be compared with what could have conceivably happened if no regulation had been implemented. The latter is called the contrafactual state.

1.3 The history of deregulation and the development of the Postal Services Act

The decision to deregulate the postal market was preceded by studies of predicted future conditions within the EU, and expected changes on the market. Several studies had examined the Post Office and its operations in the late 1980s, dealing with subjects such as market trends for the Post Office's services.

In 1989, the Riksdag (Parliament) auditors submitted a report entitled "*Postverkskoncernens verksamhet*" (Post Office Group Operations). This report noted that the nature of the Post Office as a public body meant certain limitations of its freedom of action, compared to that of private competitors (Govt. Bill 1990/91:87).

¹ Vedung E (1998) *Utvärdering i politik och förvaltning*, Studentlitteratur

² *Lärobok för regelnsar – en ESO-rapport om regelhantering vid avreglering*, Ds 2002:21

In the same year, the Swedish Price and Competition Board (SPK) issued a report entitled "*Prissättning på monopolmarknader – En studie av Postverket och Televerket*" (Pricing on monopoly markets – A study of the Post Office and the National Telecommunications Authority). This report analysed the market and the competitive conditions relating to various postal services. The SPK proposed pricing objectives for operations whose circumstances preclude functional competition. In addition, the SPK determined that the competition here consists largely of technical advances in the information and data processing area. This allows competing means for the transfer of information and the gaining of entry by domestic and foreign competitors to the Post Office's lucrative markets without their being required to take responsibility for serving sparsely populated areas. The report also determined that the Post Office has long held a formal and natural monopoly position regarding letters, as well as a strong market position for other mail services such as economy letters and letters from organisations.

In 1990, the Postal and Telecommunications Commission issued the report, "*Post & Tele – Affärsverk med regionalt och socialt ansvar*" (The Post Office and the Telecommunications Authority – Public Services with regional and social responsibility (SOU 1990:27)). This commission, appointed in 1988, was instructed to propose limitations and clarifications of the regional policy responsibility of the Telecommunications Authority and Post Office. The commission, known by the Swedish acronym of PTU, proposed that the regional policy and social requirements affecting the Post Office should be left basically unchanged.

In the Government Bill (1990/91:87) entitled "*Näringspolitik för tillväxt*" (Commercial Policy for Growth), the Government writes that "The Post Office shall maintain basic postal service throughout the country, with weekday, nationwide postal and cashier service. The competition facing the Post Office is increasing. The development of high tech means new methods of message processing. Competing companies that are not subject to any public policy requirements currently exist within several of the areas in which the Post Office operates. This development increases the need for measures to maintain a high level of nationwide service" (page. 108). The Government also called for a review of the structural crisis in the post office network, the exclusive right to carry mail, financial accounting aspects and legal forms of business, as well as the continued conditions and structure of the Post Office.

As part of this work, the ministerial report (Ds 1991:44) "*Postens konkurrensförutsättningar*" (Competitive conditions facing the Post Office). This study discussed the issue of the exclusive right of the Post Office to conduct postal service, and the situation the Post Office faced on a market with increasing competition. In addition it clarified the need for measures aimed at ensuring good postal service throughout the country. The Government emphasised that the market in this sector would be changing quickly through the growth of alternative forms of communication, and that developments within the European Community point to a liberalisation of the market. Finally, the Post Office must be provided with the opportunity to act in a business-like manner under known competitive conditions. This meant that the Government proposed that the consequences of reorganisation as a company should be reviewed.

In the budget bill (1991/92:100 Appendix 7), the Government set forth its views on a review of the mail monopoly, the Post Office and the need for a postal law. The Government stated that one important condition for increased cost efficiency is the elimination of limitations on competition. Deregulation and demonopolisation, as well as a more stringent fair trade law, would stimulate competition and provide incentives for new and improved methods of mail delivery, for the benefit of the consumers. The Government also favoured having the Post Office operated as a limited liability company in the future, in light of the expected competition.

In the spring of 1991, CityMail was established for the distribution of pre-sorted bulkmail from businesses and organisations in the Stockholm area. This company predicted that thanks to new technology, these customers would be able to pre-sort their mail in postal code order. A preliminary investigation was undertaken to ascertain whether or not CityMail's business operations violated the monopoly regulations, but this was discontinued when the mail monopoly was subsequently abolished.

After a decision of the Swedish parliament on 22 December 1992, the state mail delivery monopoly was abolished as of 1 January 1993. On 1 March 1994, the new Postal Services Act (SFS1993:1684) came into force, and the Post Office was transformed from a public agency, "*Postverket*," to a corporation, *Posten AB*. An agreement was executed between Posten AB (hereinafter "Posten") and the State regarding the provision of nationwide services that would guarantee everyone access to a quality postal service. The Telecommunications Board changed its name to the Postal and Telecommunications Board (PTS), and became the supervisory authority in the postal area, as well. In addition, the VAT exemption on Post Office deliveries was ended. A price ceiling was introduced for the fees individuals would have to pay for domestic letters. The Government's position was that although a functioning market should not require price regulation, continued price controls were necessary as Posten would be the dominant company on the mail delivery market for individuals.

The Postal Services Act prescribed the following goals, as of 1 March 1994: *"There should be a nationwide postal service enabling letters and packages to reach everyone. Everyone should be able to have letters delivered at uniform and reasonable prices. Private individuals should also be able to have packages delivered at uniform prices. In addition, there should be a nationwide cashier service enabling everyone to make and receive payments at uniform prices."*³

The intention of the Postal Services Act was to provide the State with the means to monitor these operations on an open market, and to ascertain whether the political objectives for postal and cashier service were being satisfied. The Government also emphasised that the legal regulation must not negatively impact competition.

The first amendment of the Postal Services Act was made on 1 January 1997, and extended the definition of basic postal service to include all addressed mail up to 20 kg. The previous registration procedure for businesses wishing to engage in

³ SFS 1993:1684

postal operations was changed to licensing by the PTS. New regulations with instructions for the PTS came into effect on 1 July 1997.⁴

The second amendment of the Postal Services Act came into force on 1 July 1998. “Basic postal service” was changed to “Nationwide postal services.” The goals of postal policy were divided into a general goal and a service goal. The Government emphasised that the development of the postal market (technical development, internationalisation and increased competition) since the Postal Services Act had entered into force had raised the issue of the State’s ability to exercise its responsibility for the nationwide services. In addition, a need was noted to adapt Swedish legislation to comply with EU law in this area.⁵ The delivery of packages was removed from the concept of “Postal operations” in the Postal Services Act, leaving letter delivery as the only postal activity requiring a licence. In addition, requirements were introduced mandating fees based on the costs for nationwide postal service and separate cost accounting to operators responsible for this kind of service. The PTS was vested with authority for the postal sector.

After the second amendment to the Postal Services Act, the general objective was that *“there should be a postal service in the entire country that enables everyone to receive letters and other addressed mail weighing up to 20 kg.”* The nationwide postal service has now been given the following service goal: *“The Postal Service shall maintain good quality, and everyone should be given the opportunity to send mail at reasonable prices. In addition, individual mail shall be delivered at uniform prices. It should be possible to insure mail and obtain a receipt from the recipient to the effect that the item has been received.”*

The purpose of the third amendment of the Postal Services Act, which came into force on 1 July 1999, was to make using the postal infrastructure fairer to all parties and easier for joint use. According to the Government, it is crucial when a market is moving from a monopoly to competition to have clear, impartial rules regarding access to the necessary infrastructure. As a result, the Postal Services Act contained a rule that the holder of a licence who owns facilities (post office boxes) for the transfer of mail is required to arrange matters so that mail carried by other licence holders can reach those facilities. The PTS, which is the licensing authority, has a statutorily granted right to mediate disputes regarding access by licence holders to the facilities of other licence holders. Basic cashier service is governed by a separate law that came into force on 1 January 2002.

In summary, this deregulation was meant as a response to the expected liberalisation of the market by the European Community, and the rapid changes resulting from alternative forms of communication. As a result, the Government proposed a deregulation of the postal market and a reorganisation of the Post Office as a corporation. This was to enable the Post Office to compete on the same terms as its private sector competitors.

⁴ PTS (1997:401)

⁵ EEC Directive on Postal Services (97/67/EEC)

Deregulation and stricter anti-trust legislation would stimulate commerce by promoting new and improved methods of mail delivery, thereby benefiting the consumers. The postal policy goal was to safeguard individual and societal needs for an efficient, coordinated and dependable postal service.

Sweden and Finland are currently the only countries in Europe that have completely liberalised their postal markets. Swedish law includes the Postal Services Act (1993:1684), as well as the Postal Ordinance (1993:1709) and the Ordinance containing instructions to the PTS (1997:401).

2 The Postal market

When undertaking a broad economic analysis, as well as making decisions regarding the structure of the regulatory framework, it is important to understand and factor into one's considerations both the fact that the postal market is no longer a homogeneous or unified one, and the fact that from a production perspective, the market can be viewed as a network service that is similar to, and different from, other network industries. The latter term relates to industries such as electric power, telecommunications and railways, all characterised by large fixed costs and low variable ones. This chapter therefore begins with a definition and delineation of the postal market, as well as a determination of the submarkets and/or segments this market can be divided into, in turn. The chapter concludes with a description and analysis of the structure and characteristics of that market.

One natural basis for a determination of what constitutes the postal market is the definition contained in the Postal Services Act.⁶ According to that law, postal operations consist of the delivery of letters in return for a fee. Letters are defined as addressed mail weighing no more than two kilos. The distribution of packages and unaddressed mail, such as daily newspapers and promotional material, is thus not considered as postal operations. The Postal Services Act also defines nationwide postal service. This includes the right of every person to receive letters and other addressed mail up to 20 kilos. Unlike postal operations, postal service also includes packages. However, only postal operations (i.e. the distribution of addressed mail) require a licence from the Postal and Telecommunications Board (PTS), the sector supervisory authority.

Peter Andersson of the University of Linköping, in an interim report to the Swedish Competition Authority, concludes that the postal market is the same as the mail market.⁷ According to that report, there are three markets related to, albeit separate from, the mail market. These are the package market, the unaddressed items market and the daily newspaper distribution market.

“From an institutional perspective, the package market is subject to the regulation of the nationwide services. Other than that, no special legislation applies, except for newspapers. From both a consumer and a producer perspective, the products supplied on these markets are sufficiently distinct (not sufficiently fungible) to be considered part of the same market.”

⁶ SFS 1993:1684 (2003:708)

⁷ Andersson P. *Postmarknaden och dess delmarknader, delrapport till Konkurrensverket, 2004*

In its documentation for the Postal and Cashier Service Commission, the PTS has divided the postal market into three component markets:⁸

- The mail market (addressed mail up to two kilos)
- Unaddressed direct advertisement (ODR)
- The package market (domestic packages weighing up to 35 kg)

Andersson's view accords with the PTS's view of the market, even though in the above-mentioned report, the Authority chose to give the postal market a broader content than what would normally be ascribed to the postal operations concept.

ITPS shares Andersson's view of the postal market and as a result, the term "mail market" will be used in this report. Only the mail market has been subject to de-regulation or regulatory changes, and the effect of these are to be evaluated according to the instructions given the ITPS. On the other hand, both the ODR and the package market will be affected to a limited extent, as ODR is produced concurrently with addressed mail in the final part of Posten's production chain. The distribution chain for packages, however, is completely separate from mail distribution, and is a good reference market, as the cost structure is relatively similar, but this market has not been regulated.

2.1 Submarkets or segments of the mail market

The major distinction to be drawn on the mail market is between bulk mail and non-bulk mail (post office mail and mailbox mail distributed as individual letters). The boundary between bulk and non-bulk mail is not sharply delineated, but is mainly the result of how the postal service operator handles the mail and of where savings and economy of scale appear. Bulk mail consists of large series of mail of the same weight and format, which are often mailed by the customer pre-sorted in postal code order. The PTS report, *Den svenska postmarknaden* (the Swedish mail market) also makes a distinction between post office mail and mailbox mail. This kind of distinction is actually not necessary in market analysis as both groups of mail are treated as individual mail, and their production processes are similar. Similarly, product designations such as addressed advertisements, letters and periodicals are not relevant in this context. These are simply terms to describe the contents of the mail.

From a producer perspective, the mail market can also be divided into five separate vertical production stages. These are collection, collection sorting, transport, delivery sorting and delivery. Traditionally, the mail market has been vertically integrated to a large degree, and this remains true for the distribution of traditional mail. This categorisation, however, is less relevant on the bulk mail market. The development of this submarket, in which customers pre-sort bulk mail according to postal code number, and prepare it for efficient processing, has meant the elimination of large parts of the

⁸ *Den svenska postmarknaden – en beskrivning och övergripande analys, PTS rapportnummer PTS-ER-2004:20*

collection and sorting process. Instead, distributors deal with the production of the bulk mail, and are central figures in this submarket. Bulk mail is thus submitted to the mail operator further down the production chain. Although the CityMail company, which specialises in the bulk mail submarket, only actively engages in the delivery stage, the company takes responsibility for the entire production chain, in consultation with the customer.

The conditions that relate to competition, as well as the competition itself and price and market trends, vary significantly between the bulk mail and individual letter submarkets. As a result, these can be seen as distinct from one another. This division was also established in what is known as the zone price case.⁹ The Market Court determined that the relevant product market was mass-mailings, and the geographic market was Sweden

An additional submarket consists of registered letters, which Posten refers to as “Ess letters.” These letters are handled separately, and largely manually, by separate personnel. However, the volume of this submarket is tiny compared to the other submarkets, and so it is not discussed further.

Another dimension is that the collection and distribution can be on a local or regional level or a national one, while a further dimension is time limits (i.e. delivery within one or three days, or by a certain date). The distinction between A and B class mail is also less relevant for bulk mail, as many customers instead want distribution on certain weekdays. In the case of both of these dimensions, it is more correct to speak of segments rather than submarkets.

2.2 Structure of the mail market

Although the postal market can be termed a “network industry”, unlike the telecommunications and electric power markets, the postal market does not have the large fixed costs or insignificant variable ones to the same extent as those do. However, it would be extremely costly to duplicate Posten’s nationwide distribution network, and the sorting stage also has high fixed costs. However, at the delivery stage, which is the part of the mail chain that accounts for the largest percentage of the costs, these expenses can be viewed as variable ones from a long-term perspective. The time perspective is crucial when discussing fixed and variable costs. From a short-term perspective, most of the costs can be fixed ones, but in the long term, the situation may be different. At the delivery stage, what drives costs is rather volume and frequency (i.e. how often the mail is distributed). Thus, direct parallels cannot be drawn to the telecommunications or electric power markets or to other operators’ access to the dominant company’s distribution network.

Mail distribution is generally characterised by economy of scale and shared production advantages, as well as a dense network that demands coordination and synchronisation. Businesses that show similar characteristics are logistics networks such as Schenker and DHL, even though these networks are not as dense. Each day, the Swedish postal market distributes about 13 million addressed items of mail

⁹ *Verdict by the Swedish Market Court 1998-11-11, dnr A 3/98*

between households and businesses. The following is a brief outline of the main characteristics of the production process (for a more detailed description of Posten's production, see Andersson).¹⁰

Traditionally, mail production can be divided into four stages or production components: collection, sorting, transport and delivery. Sorting is actually carried out in two different stages. Collected outgoing mail is sorted regionally when received according to the first two digits of the postal code. Incoming mail is then sorted for delivery by mail carrier district, according to all five digits of the postal code. Transport, too, is not a single stage, but occurs throughout the production chain. The final stage of the production chain is the delivery stage. This stage consists of the actual delivery as well as the indoor work, which consists primarily of the mail carriers dividing and sorting the mail according to the order the addresses are reached on their routes.

Posten's production of Class B mail, which is delivered within three days, is done so as to optimise production capacity primarily at the sorting stage. This means that Class B mail is sorted during the day, when there is available capacity. Class B mail is also transported by slower and cheaper means of transportation, such as lorries and trains. This means that the mail reaches the delivery stage on the same day as Class A mail sent two days later. Unaddressed bulk mail (ODR) to be delivered to all households in the same area also goes directly to the delivery stage.

The delivery stage represents more than half of the costs of individual letters. In the case of bulk mail, the percentage is much higher, about 75%. The share can be even higher for large amounts of sorted bulk mail, as there is significantly less handling in the previous stages than in the production of individual letters. The cost structure also depends on the geographical dimension. Only national mail requires inter-regional transports, but aside from that, handling is the same as for regional mail. However, the local mail does not need regional sorting, and saves delivery sorting to a certain extent. However, this is only the case for small postal service operators, and Posten handles local and regional mail in the same way.

This description of the structure of the mail market leads us to the issue of whether mail delivery is a natural monopoly. The report "*Tio år efter postmarknadens avreglering*" (Ten years after the deregulation of the postal market), Peter Andersson asserts that this applies regarding mail delivery and sorting because of of continually declining average costs, as a result of decreasing total cost function at the delivery stage and large fixed costs at the sorting stage.

We disagree with this view. It is true that a duplication of Posten's nationwide distribution network including its sorting facilities would not be economically justifiable, as there are significant economies of scale and vertical integration requirements here. The conclusion may therefore be correct for the nationwide overnight delivery of individual mail, and possibly even for the distribution of this by Class B mail. However, this conclusion does not apply to the majority of the mail market, more than 70% of which is not sorted. Andersson's analysis does not take into ac-

¹⁰ Andersson, *Tio år efter postmarknadens avreglering: effekter och reformförslag* (2004)

count the fact that the postal market is not homogeneous, but consists rather of the two submarkets for bulk and non-bulk mail. In addition, businesses do not establish their positions by imitating the production methods or geographic coverage of the dominant company. Moreover, this kind of approach underestimates changes in customer demand due to factors such as the development of new technology. We are of the opinion that this kind of approach is based on a static view of the postal market based on past performance.

The entry of CityMail on the market provides an excellent empirical example of how competitors can challenge a former monopoly. Firstly, CityMail concentrates only on the bulk mail submarket, and does not deliver throughout Sweden, but only to less than 40 percent of all addressees, those located in the three metropolitan areas plus Gotland. Secondly, operations are organised in a completely different manner from how Posten and other national postal services organise their production. Basically, CityMail has chosen only to operate at the delivery stage, and thus does not engage in any actual activity at the three earlier stages. However, the company takes responsibility for the entire distribution chain, even though it uses the services of subcontractors in the form of forwarders and distributors to comply with its customers' quality and precision requirements. The company's business concept is based on the fact that their customers, without any added cost, can use modern technology to sort bulk mail items in postal code order during production, and prepare them for efficient handling in the form of pallets or boxes. At the delivery stage, CityMail shows a high level of productivity, and is able to compete with Posten by delivering to any given area only once every three days. This enables the same mail carrier to service three routes, as compared to Posten's operations in which each mail carrier services the same one delivery route daily. Thirdly, operations are adapted to changes in customer demand, which have also been hastened as a result of the entry of the company onto the market. The customers often demand not only fast delivery but, just as importantly, reliability and deliveries on certain days.

In summary, we feel that the mail market has certain characteristics of a natural monopoly. However, this does not apply to certain components and production stages, but rather to the individual mail submarket, and especially to nationwide overnight delivery. It should also be noted that the concept of a natural monopoly is not a static one. Changes in demand or cost factors, as well as innovations and technological advances, can change the view of what is a natural monopoly. Hardly anyone today would maintain that the telecommunications market is a natural monopoly, even though this characterisation was accepted as fact 15 years ago.

On the other hand, the mail market will probably not gain additional major players, but will rather develop into an oligopoly. Thus, free competition will most likely not be the applicable model. Instead, the market will need support in the form of sector-specific regulation of matters such as access for operators to common infrastructure such as mailboxes and postal codes.

3 Market development after deregulation

3.1 Market structure

3.1.1 Players and competitive pressure

In 2003, Posten still completely dominated the Swedish mail market, with a market share of about 93 percent. Posten is the only operator covering all of Sweden, and reaches 100 percent of all addressees. CityMail is the next largest operator, with a market share of about 6.5 percent. The latter company has enjoyed a steady increase in volume since 1996 when its market share was 1.5 percent. CityMail is specialised and concentrated on bulk mail or industrially-produced mail. The company's share of this submarket is estimated at about 10 percent. CityMail has deliveries in the three metropolitan regions, as well as Gotland, reaching more than 36 percent of Swedish addressees. Collection is at the place of production, regardless of its geographical location.¹¹

There are 26 other active operators, which together account for 0.5 percent of the market. These specialise in local distribution of individual mail, and often broaden their operations to include related services. Another type of player on the market is the distributor. These companies engage in the production of bulk mail and position themselves in the distribution chain between the customer (the sender) and the operator. According to the PTS, these players handle about 65 percent of all bulk mailings.¹²

Based on the market shares of the various players, Posten's market position is a very strong one. This company has about 90 percent of the bulk mailing submarket, while the company has what amounts to an actual monopoly for individual mail.¹³ The other players in the latter submarket are only small companies specialising in the distribution of local mail. Their operations hardly affect the total market. On the bulk mail submarket, CityMail exerts relatively strong competitive pressure in relation to its market share, and this competition is the major factor affecting Posten's price structure and pricing.

The competition from CityMail has also led to innovations and market growth. CityMail also introduced the *Svensk Adressändring* change of address and mail forwarding service. Today, the operators jointly manage this service, which is considered part of the common infrastructure. According to CityMail's business concept, precision and reliability are as important to the bulk mail customer as rapid delivery. CityMail also discovered that the customers who had access to new technology could sort mail by postal code in their production and prepare it for efficient handling, at no additional cost

¹¹ Post- och telestyrelsen, *Den svenska postmarknaden (rapportnummer PTS-ER-2004:20)*

¹² *Ibid*

¹³ *Ibid*

This competition affects and encourages the change in customer behaviour. Originally, Posten did not offer any direct discounts for these labour-saving acts, but charged basically the same price for bulk and non-bulk mail.

Is this development then a failure? According to the previous chapter, the non-bulk postal market, and especially nationwide overnight deliveries, have characteristics of a natural monopoly. There are economy of scale advantages on the bulk postal market, and as a result, we can expect to see a small number of major players. According to the legislative preparations for the Postal Services Act, Posten was expected to continue to be the dominant company on the mail market for the foreseeable future, and especially concerning the delivery of the individuals' mail.¹⁴ The fact that there are only two major players on the market is therefore not a failure, but rather a fairly normal development, given this background. On the other hand, Posten's predominance is most likely larger than what the government had expected. One factor that was not predicted is the extensive fair trade disputes that will be discussed below.

3.1.2 Fair trade rules and competition issues

As mentioned earlier, developments on the mail market of the early 1990s first began in the form of CityMail, and culminated in the end of the monopoly, about a year later. Just over a year after that, the Post Office was restructured as Posten Sverige AB, and the new Postal Services Act came into effect. This new law, however, did not actually contain regulations other than a price ceiling for mail sent by individuals, which was further detailed in the agreement between Posten and the State. Other issues, such as access to the postal infrastructure, were not regulated, as it was hoped that these would be resolved by the players on the market. Armed with 20/20 hindsight, we can now say that it would have been better to first restructure Posten and equip the Postal Services Act with a more detailed regulatory scheme before competition began. In a way, the events that occurred illustrated free enterprise, as an entrepreneur saw business opportunities that no one else noticed before. The fact that legislation did not keep pace with these developments is therefore neither surprising nor something unique to the postal market.

When describing the development of the Swedish mail market, it is impossible to avoid discussing the fair trade disputes that permeated that market in the 1990s. Posten countered competition primarily from CityMail through the form of selective pricing and other types of unfair trade practices that according to the Swedish Competition Authority violated the prohibition against unfair use of dominant status pursuant to Section 19 of the Competition Act. At first, these consisted primarily of actions such as loyalty discounts, annual bonus systems and exclusiveness clauses. After the Authority acted, Posten instead began to apply various forms of price adjustment and pricing information clauses in order to promote customer loyalty. These practices, too, were prohibited by the Swedish Competition Authority.

¹⁴ *Government. Bill 1993/94:38*

Posten then began using various forms of geographical price differentiation (i.e. charging a lower price for deliveries to areas where Posten was encountering competition from CityMail). These fair trade disputes culminated in the autumn 1996 announcement by Posten of zone price lists. It should be noted that these were introduced despite the Competition Authority rejecting in that same year Posten's request for negative clearance for geographically differentiated pricing.¹⁵ In October 1996, Posten announced the four-zone price list, which gave the largest delivery discounts to Greater Stockholm, Göteborg, Malmö-Lund and Uppsala. This was rejected by the Competition Authority in an interim decision, dated 1 November 1996, and later by a final decision dated 22 November 1996.¹⁶ The Competition Authority's decision was justified by the fact that the pricing system in itself constituted an abuse of a dominant position, as the pricing was not justified by cost, made it difficult for other companies to compete on the market, and was intended to eliminate existing competition.

On 4 November 1996, Posten announced a two-zone pricelist, which differed from the four-zone pricelist by giving the largest discount to all 19 large urban centres in Sweden, including those mentioned above. According to a new interim decision dated 6 November 1996 and final decision dated 19 December 1996, the Competition Authority also prohibited Posten from applying the two-zone price list, on the same grounds used regarding the four-zone pricelist.¹⁷ These decisions were appealed to the Stockholm District Court, which affirmed the Competition Authority's decisions regarding the request for negative clearance and the four-zone price list. The District Court, however, reversed the Competition Authority's decision regarding the two-zone pricelist. This judgment was appealed to the Market Court (the highest court with jurisdiction to hear this case), which affirmed the decision of the District Court.¹⁸

The Market Court determined that Posten, during the period in question, acted with the intent, to the extent possible, to eliminate competition from CityMail. Assessing the totality of the circumstances, the Market Court found cause to characterise Posten's actions during this period as a form of abuse of a dominant position. However, after a study of a report of costs, the Court opined that in the case of the two-zone pricelist, Posten had satisfactorily reported that the costs of distribution in the zone area were lower than the costs of distribution in the rest of the country. As a result, Posten was found to have objective reasons for pricing according to the two-zone pricelist.

The Market Court decision clarified the fair trade rules regarding selective pricing and price differentiation. The court's decision meant that Posten has the right to counter competition, but as Posten is dominant on the market, especially stiff requirements must apply to Posten's behaviour regarding competition. In other words, Posten must act with caution, as must other players with market dominance. The decision of the Market Court, like the Competition Authority's previous deci-

¹⁵ *Competition Authority's decision (dnr 601/96)*

¹⁶ *Competition Authority's decision (1074/96)*

¹⁷ *Competition Authority's decision (dnr 1142/96)*

¹⁸ *Market Court's decision (A 3/98)*

sions have meant the creation of a body of case law that follows European Community law, as the new Competition Act (KL) had been drafted based on Community law examples. In light of all this, Posten's actions during the years immediately following the Competition Act coming into force on 1 July 1993 appear unusual in certain respects, despite the newness of the situation for the previous holder of a monopoly. This especially applies to the use of various clauses aimed at creating customer loyalty effects, as Community law generally forbids players that are dominant on a market from using these kinds of measures. As Posten should have been aware of this at the time in question, these actions appear to be more or less intentional.

Another fundamental issue dealt with by the Competition Authority concerned conditions and principles for access to Posten's post office boxes by other postal operators. As these issues were not set forth in detail in the Postal Services Act, they had to be determined by the Competition Act instead. In a decision dated 13 October 1997, the Competition Authority held that the post office box system is a "necessary facility". In order not to abuse its dominant position, Posten must make the post office box delivery service available to other postal operators upon reasonable, non-discriminatory terms that were not less advantageous to the competitors than to Posten's own operations.¹⁹ These formulations were basically included in the Postal Services Act with the law was amended in 1999. The Competition Authority's decision and the subsequent amendment of the Postal Services Act clarified the fair market rules in an additional important area.

The disputes regarding competition law and the earlier regulatory uncertainty have inhibited the growth of competition. It should be noted that it took two years from the Competition Authority's decisions and the decisions by the Market Court regarding the zone pricelists discussed above. This type of drawn-out dispute generally hits smaller players harder, as they have fewer personnel and financial resources than the dominant company has. They have less staying power, as a result. The Competition Authority has played an important role for the development of the mail market, which shows how vital it is for authorities charged with protecting competition to focus special attending on deregulated markets.

Two public sector agreements

After the millennium, conditions normalised, and competition law disputes basically ceased, at least from the aspect of Competition Authority measures. Despite this, Posten continues to apply aggressive pricing on the bulk mail submarket, and especially in those segment and delivery areas where CityMail is active. In recent years, Posten has applied the *Storstad* (metropolitan area) model, which means that mailings of at least 5,000 items to the 19 largest urban areas cost 40 öre less per letter than equivalent mailings to the rest of Sweden would cost

Posten allows additional discounts in individual agreements. An example of this is the general agreement with the Tax Authority, which is discussed in greater detail in section 3.2.3. In 2004, the list price for a 20-gram economy letter in a mailing of

¹⁹ *Competition Authority's decision (dnr 389/96)*

50,000 letters was SEK 2.74, excluding VAT. The list price for distribution within *Storstad* areas was SEK 2.31, excluding VAT. The corresponding prices according to the agreement are SEK 1.89 and 1.69 (*Storstad*). The latter price means an additional discount of 62 öre/letter, or 27 percent on list price for delivery in the *Storstad* region. Considering the large volume of mail covered by this agreement, which applies to the entire State sector, Posten loses enormous amounts of income. We do not know how these prices relate to costs.

Another example is Posten's quote in the PPM Pension Authority procurement tender for the mailing of its Funds Catalogue in 2000. According to the PPM tender evaluation documentation, Posten's price for nationwide delivery was about SEK 48 million.²⁰ If Posten had applied the prices according to its pricelist in effect at that time, the price for delivery in Stockholm and on Gotland would have been about SEK 12 million, while the price for delivery to the rest of Sweden would have been SEK 50 million. This is based on a submission of more than 50,000 pre-sorted letters.²¹ Thus, Posten chose to forego about SEK 2 million, at the same time as it distributed all this mail throughout the country, including those to the areas in which CityMail delivers (i.e. Stockholm and Gotland). Incidentally, this customer could not dispense with the mailing in question, but despite that, Posten chose to offer the PPM a discount of about SEK 14 million or 23 percent.

It should be noted that the list prices referred to above are set on the basis of the savings derived from actions by the customers. The list prices that apply in both these cases were for pre-sorted mailings of at least 50,000 pre-sorted letters. Thus, the discounts that Posten offered the Tax Authority and the PPM in these agreements were due to competition.

3.2 Volume and price trends

3.2.1 Volumes and volume trends in the mail market²²

A more detailed description is available in PTS reports, so only the main trends are considered here. In the period 1993–2003 the overall mail market was reasonably stable, and the volume was approximately 3.3 billion mail items annually. However, in the last three years, there has been a downward trend averaging 1.5 percent per year. According to Posten's interim report for 2004, the volume of mail increased by three percent in the first six months. The trends are different for different segments of the mail market, which will be discussed below.

The total distribution value of the mail market was approximately SEK 11 billion in 2003. Sixty-eight percent of the communications flow was from businesses to households, and 26 percent between businesses. The communication between household, and from household to businesses, is negligible in this context. This means that businesses pay approximately 96 percent of the postage costs. In 2003, 73 percent of the volume comprised the letter mailings, while 20 percent was office

²⁰ PPM, *Utvärderingsrapport (Dnr 00-65-13)*

²¹ CityMail, *Marknaden för datoradresserad post, 2002-03-18*

²² *This section is largely based on the PTS report Den svenska postmarknaden (PTS-ER-2004:20)*

post and 7 percent mailbox post. The total volume sent has been constant for the last three years, but trends for different type of mail show differences in volume. The volume of addressed direct advertisements (ADR) is approximately 35 percent higher than it was in 1993, and growth in 2003 was just under three percent. The volume of administrative mail sent as economy letters has grown in recent years, and growth was about four percent in 2003. There has been a switch to Economy Post from the overnight delivery products, and in the letter segment, the proportion of mail with slower delivery is just over 80 percent compared with 75 percent in 1994. The total number of bulk mail items in Posten's First-Class mail has fallen by around 16 percent between 1993 and 2003, which clearly illustrates the shift from products with overnight delivery to economy letters. The fourth segment of mail is publications, for which the corresponding volume information is not shown, but the volumes are probably relatively constant.

In the ten-year period 1994–2003 Posten's volume of individual letters has decreased by approximately 150 million items, or just over 15 percent. This is a major decrease, bearing in mind that the overall market for addressed letters in the same period decreased by only two percent. For post office mail, the relationship between economy letters and letters for overnight delivery is the opposite compared with the letter mailings. This means that first-class letters comprise approximately 80 percent of the volume. The biggest decreases in volume have been for stamped letters, where the annual volume has decreased by half compared with 1994. The volume decrease for both office and mailbox post can probably largely be explained by the switch to communication via e-mail and the Internet for businesses, organisations and households.

The volume of unaddressed direct advertisements has grown strongly, and increased by 55 percent between 1993 and 2003. In 2003, ODR was Posten's largest product in terms of volume.

In summary, the total volumes on the mail market have been relatively constant over the last ten years. In the letter segment, the volume of both addressed direct advertisements and economy letters has increased. Similarly, the unaddressed direct advertisement market has also grown strongly. The segments that are decreasing are overnight letters and individual items, which mainly comprise first-class letters. It is primarily in the latter segment that competition from alternative forms of communication have made an impact and influenced volume trends.

3.2.2 Price trend

Simply analysing price trends through pricelists is misleading when describing trends on the mail market since deregulation. This is because the pricing for most of the volumes is done via agreements with individual customers. These prices are generally lower than the official prices shown on Posten's pricelists. This applies especially to the bulk mail segment and the approximately 75 key customers that are responsible for much of the volume on the mail market. These customers enjoy significant discounts that are regulated in confidential agreements. As previously mentioned, letter mailings comprise approximately 73 percent of the mail market's volume.

According to PTS, a very rough estimate shows that the average nominal prices for 50-gram letters in bulk at the start of the 2000s was at least 30 percent lower than at the start of the 1990s. Allowing for inflation, this should correspond to nearly 50 percent in real terms.²³ To get an impression of the overall price trend on the mail market, the trend for mailings must be considered in relation to price trends for individual mail items. According to Andersson, the individual letters have become 30–50 percent more expensive since deregulation. In view of the price changes for different types of mailings, he comes to the conclusion that the overall price level for letters is unchanged, or slightly higher than before the deregulation.²⁴

Our view is that such a conclusion cannot be drawn as there are many products, different weight classes and, last but not least, the prices on much of the market are unknown. A more accurate picture of the price trend on the mail market can instead be obtained by looking at how the total operating income per letter has developed for the former business area, Posten Brev. In 1994 the average operating income per letter was approximately SEK 4.21, excluding VAT. In 2003 the same key figure was SEK 5.28 excluding VAT.²⁵ This means that the overall average operating income per addressed item of mail increased by 25 percent in nominal figures during this period. Inflation over the same period, measured as the change in the CPI between 1994 and 2003, was 11.8 percent. Consequently, the trend for the average income has exceeded the general price trend by approximately 13 percent over the same period.

A small part of the business area's total income derives from other services than delivery of addressed mail. The above figures are for all operating income for the business area. A better measure of the price development on the mail market can be obtained if only the income from addressed domestic mail is considered. However, this information is only available for the years 1998 to 2003. The average income per addressed domestic mail item was SEK 3.74 excl. VAT in 1998. The corresponding figure for 2003 was SEK 4.05 excl. VAT, which is an increase of 8.3 percent.²⁶ The change in the CPI in this period was approximately 8.1 percent. Therefore, the price trend in recent years has been in line with inflation.

It can also be of interest to consider the nature of the price trend between 1991 and 1994, i.e. the years immediately prior to the deregulation, because it can be assumed that the Post Office of that time had already started to adjust to the forthcoming deregulation. According to information in Posten's annual report for 1995, the average income per mail item fell by 4.5 percent between 1991 and 1994. However, the information for the different periods is not directly comparable with each other.

²³ *Post- och telestyrelsen, Service och konkurrens 2004 (rapportnummer PTS-ER-2004:17)*

²⁴ *Andersson, Tio år efter Postmarknadens avreglering*

²⁵ *Source: Posten's annual report and letter volumes according to PTS. Information for 2003 was recreated by Posten as the previous business area Brev is no longer shown separately.*

²⁶ *Source: Posten Sverige AB*

Finally, it should be emphasised that the above information only applies to Posten, but the company has approximately 93 percent of the mail market, and is price leader on account of its market-dominating position. The information is therefore a good approximation of the price trend for the entire mail market. It can also be assumed that the only competitor of significance, CityMail, offers prices that generally do not exceed Posten's.

3.2.3 Greater price differentiation due to competition and increased adaptation to costs

The PTS report, "The Swedish Postal Market", describes price and discount trends for mailings by studying the agreement prices for the National Tax Board (formerly called RSV). The reason is that this agreement is one of the few that is public. The price trends in this agreement, and the relationship to the list prices, gives an excellent illustration of how the price structure has changed since deregulation. In 1993 the discount for one letter in a mailing of 50,000 items was 4.2 percent compared with the price for an individual stamped letter, and 7.1 percent compared with RSV's agreement with Posten. Ten years later, the National Tax Board signed a new general agreement for the whole of the public sector that applied until 31-3-2005. The list price for a corresponding mailing gives a discount of 31.5 percent, and the agreement gave a further 21 percent, so the total discount was nearly 53 percent in relation to the price of an individual stamped letter.²⁷

As for the price levels, it can be noted that in 1993 the list price for a 20-gram economy letter in a mailing of 50,000 items was SEK 2.30 excluding VAT. In 2004 the list price was SEK 2.74 excl. VAT. In the area where Posten meets competition from CityMail, i.e. Storstad (metropolitan areas), the list price is SEK 0.43 lower, or SEK 2.31 excluding VAT, which is the same level as 1993. In the current National Tax Board agreement, the corresponding prices are SEK 1.89 and SEK 1.69 for delivery in metropolitan areas. The latter prices can be compared with RSV's price in 1993, which was SEK 2.23 (there was no special price for metropolitan areas at that time). So the prices are approximately 15 or approximately 24 percent lower in nominal figures depending on the delivery area compared with 1993. In the same period, the CPI has increased by 14 percent.²⁸

The above figures give a clear picture of what has happened with prices and discounts since deregulation. It should also be emphasised that this development is largely a result of competition on the segment for mailings. At the time of deregulation, the price was the same in principle, regardless of mailing type or volume. Customers that took, or could take, cost-reducing measures got no real discount for this. Today's pricing reflects more the underlying costs, i.e. there has been a greater adaptation to costs, so the individual and overnight mailings have become relatively expensive in relation to bulk mail. Customers that take cost-reducing measures by pre-sorting large batches qualify for major discounts.

²⁷ *Post- och telestyrelsen, Den svenska postmarknaden (rapportnummer PTS-ER-2004:20)*

²⁸ *Source: PTS*

The price structure is therefore more cost-related, but as Mats Bergman points out, the difference between the respective segments that are, in reality, subjected to competition and protected, is remarkable.²⁹ Competition has been tough on the mailings segment, and this has really pressed price levels. According to PTS, it cannot be excluded that the competition has resulted in price levels that previously meant negative operating margins for the operators.³⁰

To summarise, the pricing is more cost-related and has probably almost reached the marginal cost for the mailings segment. Such prices are economically efficient, and so deregulation has brought broad economic benefits in this respect. The overall price trend, measured as Posten's average income per letter, increased by approximately 25 percent between 1994 and 2003. This means that price rises have exceeded the change in the CPI by 13 percent. However, in the last five years, the price trend, measured as the change in the average income for addressed domestic mailings, has been in line with inflation. Individual letter mailings have become between 30 and 50 percent more expensive in this period, so letters in mailings have increased less in price. A certain volume shift away from more expensive individual letter may have influenced income trends. This situation has been accentuated with Posten choosing to apply lower prices on mailings.

Price trends in relation to the package market

If the senders of mailings are the winners of deregulation, are the customers whose volumes are too small for mailings the losers? Not necessarily, because this trend is partly a result of increased adaptation to costs. It can also be noted that price trends on the package market, which was already a competitive market, have been similar to the market for individual mail items. According to PTS, the list price for Posten's biggest product, *Företagspaket* (Business Package), which is only available to businesses, increased by 75 percent between 1993 and 2003. The price trend is approximately the same, irrespective of weight. In the same period, small and medium-sized companies with small mail volumes that are insufficient for the mailing discounts have seen the cost of individual mail items increase by 50 percent.³¹ This is an interesting comparison to make, because Posten has a strong, but not as dominant, position on the package market. Furthermore, the cost structure should be relatively similar. This comparison with the package market, and the fact that the prices on the mail market today are more related to underlying costs, make it difficult to say that some customers are direct losers on the mail market as a result of deregulation. Small customers on the related package market have also been affected by big price increases.

²⁹ *Lärobok för regelnissar – en ESO-rapport om regelhantering vid avreglering, Ds 2002:21*

³⁰ *Post- och telestyrelsen, Den svenska postmarknaden (rapportnummer PTS-ER-2004:20)*

³¹ *Post- och telestyrelsen, Den svenska postmarknaden (rapportnummer PTS-ER-2004:20)*

3.3 Service trends, quality, and fulfilment of USO

3.3.1 USO and regional aspects

The USO, Universal Service Obligation, or the nationwide postal service, is regulated in Section 1 of the Postal Services Act (1993:1684)

“There should be a postal service in the entire country that enables everyone to receive letters and other addressed mail weighing up to 20 kg. The Postal Service shall maintain good quality, and everyone should be given the opportunity to send mail at reasonable prices. In addition, individual mail shall be delivered at uniform prices. It should be possible to insure mail and obtain a receipt from the recipient to the effect that the item has been received.”

USO therefore applies to all addressed mail of up to 20 kg. The services must be available to everybody, and be provided at a reasonable distance from the home or workplace. The density of the service network must take into account the needs of the sender. Mail is to be collected and delivered at least five times a week (working days).

Accessibility of the postal service

In 2001 Posten AB restructured its service network for mail and package services. The changes were mainly in response to falling demand for cashier services. Posten chose to separate the cashier service from the mail and package service, which was provided by the traditional post offices. The cashier service was transferred to an independent company, *Svensk kassaservice*. The mail and package business is largely handled via contractors, at outlets such as local supermarkets and petrol stations. The new service network has three levels of service. Mail and package services are usually provided through retail outlets, but some service centres provide limited services and sell only mail products. Finally, Posten’s own service centres provide full postal service to, primarily, businesses.³²

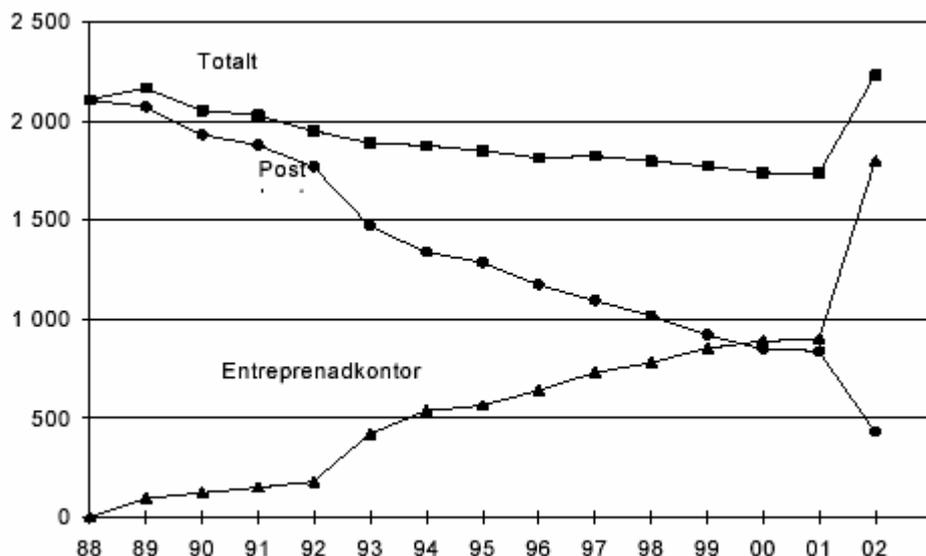
The traditional post offices disappeared as the new service network was built up. However, post offices at contracted outlets are not a new phenomenon, as they were introduced as early as 1989 when 94 contractor offices opened. The reorganisation in 2001 was another step in a trend that was already under way.

Figure 3.1 shows the changes that took place between 1988 and 2002. The number of post offices increased between 1988 and 1989 when the Post Office started to introduce contractor post offices. This was followed by a steady decline in the number of post offices until 2000. After the restructuring of the service network, the total number of post offices increased considerably. The diagram also shows that the number of contracted service outlets increased markedly after the reorganisation, and that Posten’s own service outlets became fewer, but that the total number has increased to the same level as in 1989.³³

³² There are three level of service outlet: *Posten partner brev*, *Posten partner brev- och paket* and *Postcentra*.

³³ *SIKA Postverksamhet 2002*

Figure 1 Posten's service outlets, 1988-2002



Source: Posten AB/SIKA

Change in diagram – Post offices, Contracted outlets, Total

It is not possible to directly compare the number of “old” post offices before the reorganisation (which included cashier service) and today’s post service outlets, because they do not provide the same sort of services. The total number of service outlets has increased, and the opening hours have often been extended, so it can be assumed that accessibility has been improved for most people.

Regional aspects

What are the regional effects of the reorganisation? We have chosen to only consider the trend for the different types of region after Posten’s restructuring of the service network. The division into type of region is the same as that applied by the Swedish National Rural Development Agency. Table 3.1 shows the trend for the number of postal service outlets between 2001 and 2004. The restructuring increased the number of service outlets with mail and package service from 1,452 in 2001 to 2,039 in 2004. This is a total increase of 587, just over 40 percent. The increase has mainly taken place in urban areas, while the number of service outlets in sparsely populated and rural areas has fallen in the same period.

Table 1 Trends in the number of post service outlets between 2001 and March 2004.

Type of region	2001	2003	2004	2001-04	Change in percent
Sparsely populated areas	129	109	99	-30	-23
Rural areas close to urban areas	542	480	462	-80	-15
Urban areas	781	1,498	1,478	697	89
Total	1,452	2,087	2,039	587	40

Source: Posten AB and Swedish National Rural Development Agency, March 2004.

When Posten extended the new service network, it was noted that some offices lacked sufficient customers (fewer than 30 visits per day). These offices were then replaced with rural postmen. Posten's present structure for rural postmen, and the underlying delivery policy, was set up in the 1960s. Posten and the National Post and Telecom Agency (PTS) collaborated to clarify the policy in 2002. The delivery policy was adapted to the new conditions brought about by the demographic changes in recent decades. Today, there are 2,500 rural postman routes that serve 726,000 households.³⁴ The number of rural postman routes has increased since the introduction of the new service network. In the last year, for example, a further 11,000 households have been provided with the rural postman service. This increase has partly compensated for the disappearance of fixed service outlets in sparsely populated and rural areas shown in the table above.³⁵

Today, there are approximately 30,000 post boxes, of which 17,000 are rural postman boxes (the postman collects the post), throughout Sweden. This gives a figure of approximately 33 post boxes per 10,000 inhabitants. In comparison, the average for EU-15 is 18 per 10,000 inhabitants.³⁶

According to PTS, 1,187 households lacked daily postal delivery in 2002. The corresponding number in 1990 was 1,594 households.³⁷ This means that fewer households lack access to daily postal delivery today compared with the situation before deregulation. Most of these households are situated in remote parts of the country, in mountainous regions or in the archipelago.

Quality requirements

The Directive of the European Parliament and of the Council on common rules for the development of the internal market for Community postal services and the improvement of the quality of service, specifies quality standards for cross-border mail in the community.³⁸ The goal is that 85 percent of bulk mail should reach the recipient three working days after posting, and 97 percent is to be delivered five working days. These EU directives have since been revised and implemented in each country's laws.

For Sweden, this means that at least 85 percent of the mail handed in for overnight distribution, regardless of where in the country they were posted, is to be delivered within the country on the next working day, and at least 97 percent of the mail is to be delivered within the three subsequent working days.³⁹

In 1997 Posten introduced a new measuring system, SWEX, to measure the quality of the postal service. The measurement uses test letters, and follows the entire chain from sender to recipient, and includes different ways of posting letters and the method of distribution. An independent consulting company conducts the tests,

³⁴ *Post- och Telestyrelsen, 2004*

³⁵ *Glesbygdsverket årsbok 2004*

³⁶ *PTS*

³⁷ *Post- och telestyrelsen, Service och konkurrens 2004 (rapportnummer PTS-ER-2004:17)*

³⁸ *97/67/EEC, 15 December 1997*

³⁹ *Postförordningen 1993:1709*

and Det Norske Veritas reviewed the system in 2002 and 2003. Of the bulk mail handed in for overnight conveyance in 2003, 95.7 percent was delivered on the next working day, while 99.8 percent of the bulk mail was delivered within three working days.⁴⁰ Posten thereby surpasses the statutory requirements with a broad margin, and it does so for commercial reasons.

Table 3.2 shows how well other countries achieve the targets for national quality requirements. The information refers to the countries' overnight conveyance of mail corresponding to Sweden's first-class letter, in 2003. Swedish mail conveyance is of high quality, even in an international perspective.

Table 2 Achievement of quality requirements

Post Office Administration	National requirements	Results
Posten Norge (Norway)	85 %	87.7 %
Deutsche Post (Germany)	80 %	94.5 %
Post Danmark (Denmark)	97 %	95.1 %

Source: Posten

Universal service obligation

Only a few studies have considered the costs incurred by Posten in maintaining the nationwide postal service. The latest on the subject is the Ministry publication "*Statens ansvar på post och betaltjänst området*" (State responsibilities in the postal and payment service areas).⁴¹ The following quote is taken from this report.

"Most of the extra costs claimed by Posten AB for explicit and perceived official requirements will disappear with the proposals described in this memorandum, or comprise costs that Posten Brev must nevertheless bear to maintain its own commercially motivated postal service. Furthermore, ÖC&L's report shows that Posten Brev made substantial profits in the years 1992–1996. The forecast is that the profit margin will decrease until 2003. However, this is not due to the official requirements, but to market trends and competition from new technology, which according to ÖC&L, leads to price adaptation and some volume reductions in physical mail. The total can be approximately SEK 100 million, which comprises the actual extra costs incurred by Posten AB for maintaining the nationwide postal service."

⁴⁰ Post- och telestyrelsen, *Service och konkurrens 2004* (Report no. PTS-ER-2004:17)

⁴¹ *Ds 1997:58 Statens ansvar på post- och betaltjänstområdet*

If we turn our attention to two of our neighbouring countries, we can report that Posten Norge has reviewed the cost of the USO. According to the new method of calculation, the estimated costs for USO are two percent of Posten Norge's sales. The Norwegian state compensates Posten Norge, which has a monopoly on mail conveyance, in accordance with the new method of calculation. This was NOK 305 million in 2003.⁴² The report on which this information is based suggests that a more flexible USO would eliminate the cost. The report is referring to the frequency of delivery, which is currently six days a week.⁴³ Finally, it should be emphasised that neither the Swedish nor the Norwegian studies take into account the income deriving from being a nationwide service.

Finland has had a deregulated postal market since 1994. The regulating authority, Ficora⁴⁴, ensures that the market fulfils the requirements for the nationwide postal service. A licence is required to operate postal activities in Finland, and this requires the payment of a licence fee to the Finnish Government. The fee is calculated according to a percentage rate of 5 – 20 percent of the postal company's income, varying in accordance with the population density in the region covered by the licence. According to Ficora, the falling mail volumes and the fees for new postal companies is the reason why no competing postal operator has set up in Finland.

In 1998, the NERA consulting company conducted a study of the cost of providing nationwide postal services in eight EU countries. The study was based on figures for 1997. The countries were Austria, Denmark, Finland, France, Greece, Ireland, Portugal and the UK. According to NERA, the added cost is less than 0.5 percent of the sales for the postal operators. The exception was Austria, where the cost was no less than 8 percent of the sales, but this can partly be due to uncertain data.⁴⁵

In connection with deregulation in Sweden, a price ceiling was introduced in 1994 as the maximum cost to individuals for domestic conveyance of mail of up to 500 grams. The price ceiling was specified in an agreement with Posten. The structure of the price ceiling was not totally successful, because it allowed normal postage to be increased by 30 percent in March 1997, even though inflation was low. Consequently, a new price ceiling was introduced, restricting increases in normal postage to no more than general price trends. The CPI replaced the previously used net price index as the ceiling for price trends. In reality, the postage can be increased by a greater amount, because of the rounding-off mechanism applied. The cost of individual mail increased by more than 50 percent between 1993 and 2003.⁴⁶

According to the Postal Services Act, the nationwide postal service is to be provided at reasonable prices. An interpretation of "reasonable" can be that these prices are to be cost-related. PTS feels that further studies are needed in order to establish the extent to which Posten's mail and package services fulfil the requirement for cost-based prices.

⁴² *Norske Post- og teleseksjonen/Samfjeldselsdepartementet*

⁴³ *Posten Norge, Kristin Bergum The Universal Service Obligation – a strategic perspective on service level and cost – Calculating the burden of the USO – the Norwegian experience*

⁴⁴ *Finnish Communications Regulatory Authority, Ficora.*

⁴⁵ *NERA (1998), "Costing and Financing of Universal Service Obligations in the Postal Sector in the European Union", Final Report for EC DG XIII.*

⁴⁶ *Post- och telestyrelsen, Service och konkurrens 2004 (rapportnummer PTS-ER-2004:17)*

In summary Posten AB seems to fulfil the USO requirement for the nationwide postal service pursuant to Section 1 of the Postal Services Act. The requirements for service and quality, as defined by the most central and most commonly used criteria, are easily fulfilled, and this has not been affected negatively by deregulation. Posten also fulfils this postal policy objective, i.e. high-quality daily conveyance of mail, on commercial grounds. The calculations for Sweden and other countries indicate that the extra costs for the nationwide service are small in this context.

3.4 Productivity and profitability trends

A common view is that improvements in the efficiency and productivity of the former monopoly, Posten Sverige, are some of the major benefits of deregulation. However, no official information has ever been available on the scale of these productivity gains for the mail distribution itself. ITPS has therefore acquired documentation from Posten showing the trends for delivered volumes per annual employee in the mail organisation. This information indicates major improvements in productivity around 1993/94, when productivity increased by nearly 20 percent when measured as the number of delivered items of addressed mail in relation to the number of yearly employees. The main explanation for this improvement is the new employment agreement introduced around that time.

Improvements in productivity slowed in the subsequent years, and between the 1994 and 2000 it improved by a further 10 percent. Between 1993 and 2000, productivity improved by 32 percent. Since 2000, the productivity improvement has stagnated, partly as a result of reduced volumes and also because rationalisations had not reached full impact. However, the figures for 2001–2003 are not fully comparable with the information for previous years because of changes in Posten's organisation.⁴⁷

In itself, it is not surprising that changes in productivity can be observed during the period referred to above, because productivity in most industries increased. However, the rapid improvement in 1993/94 can largely be attributed to deregulation and the transformation of Posten into a commercial company, which took place at that time. What is interesting to note is that productivity improvement since then has been slow, and has stagnated in recent years. A contributory reason for this can be the doubling in the volumes of unaddressed bulk mail per yearly employee in the above period. However, the pattern is roughly the same for the overall productivity trend when ODR is also taken into account. Furthermore, Posten's joint production economies may not as large as those that commonly applying in various situations. For example, the joint production of ODR and addressed bulk mail does not just bring advantages; it also limits the possibilities to improve the efficiency of Posten's delivery organisation.

It is also surprising that changes in the product structure, i.e. that the proportion of volumes sent has increased, and that the customers carry out a greater share of cost-reducing measures, do not seem to have had a greater impact on productivity trends.

⁴⁷ Source: *Posten Sverige AB*

An illustration of Posten's profitability is that the operating profit after depreciation in the mail business was around SEK 1 billion per year between 1993 and 2003. The exceptions were 1996 and 2002 when the operating profit was around SEK 500 billion because of major investments. The operating margin was between 6 and 8 percent in this period, apart from 1996 and 2002, when the margins were 3.6 and 3 percent respectively. At its peak in 1994, the operating margin was 10 percent.⁴⁸ CityMail's profitability has been very restricted due to stiff price competition in the bulk mail segment where price is one of the main competitive tools. According to CityMail, the overall business has been in the red in principle every year, except for last year.

⁴⁸ *Information for 2001 – 2003 have been recreated by Posten. Other information is taken from Posten's annual reports.*

4 U.S. Postal Service

Introduction

As mentioned earlier, it is impossible to know how the Swedish mail market would have developed had it not been deregulated. It can therefore be interesting to illustrate how the US mail system works. The United States is often cited as the promised land of the market economy, but this does not apply to the mail service. The United States has chosen to retain the monopoly for mail conveyance, and the USPS even has sole right of access to the addressees' mailboxes. A regulator monitors pricing and discounts. Although the American system has a completely different structure to the Swedish mail service, there are nevertheless some similarities. In particular, this concerns the use of worksharing discounts for mail, where the customer gets a discount for cost-reducing handling in the production stage before the delivery stage.

4.1 Background

In the 1960s, the U.S. *Post Office Department* was in severe financial difficulty. In April 1970 a proposal was put forward that contained four important provisions: improved financing, greater independence from the political system, collective bargaining between management and employees, and the right to set postage rates after approval by an independent panel. The proposal led to the adoption of the Postal Reorganization Act of 1970. The new legislation was primarily aimed at creating a new organisation with the financial and organisational freedom lacking in the former, and strongly political, organisation.

The Postal Reorganization Act of 1970 comprised the following components:

- Operational management consisting of a *Board of Governors*, of which nine members are appointed by the president in consultation with the Senate, and an executive management group instead of Congress. The operational management approves rates and classification changes following recommendations by the *Postal Rate Commission (PRC)*.
- Authority to issue public bonds to finance investments in buildings and equipment.
- Responsibility for collective bargaining between the management and unions.
- The new rate-setting procedure brought about the formation of an independent regulatory authority, the PRC.

The implementation of the new Act meant that the Post Office Department changed name to the *United States Postal Service (USPS)* and became an independent part of the US administration. The cost was transferred from the taxpayers to the postal customers and the service was run more as a commercial enterprise. The current USPS structure is largely based on this Act, and only two minor additions have been made since 1970.

The PRC is separate from the USPS, but operates on assignment by the USPS or after complaints from other interested parties. Its primary task is to provide recommendations to the USPS regarding postal rates, charges, and mail classification. The PRC reports annually to Congress. The PRC, which is financed by the USPS, has around 50 employees.

The monopoly and the public ownership that were central to the former organisation were retained, and the purpose and objectives were unchanged.

*“The Postal Service shall have as its basic function the obligation to provide postal services to bind the Nation together through the personal, educational, literary, and business correspondence of the people. It shall provide prompt, reliable, and efficient services to patrons in all areas and shall render postal services to all communities.”*⁴⁹

The USPS has a monopoly on both the use of mailboxes and distribution of mail. The USPS defines mail as “a message directed to a specific person or address and recorded in or on a tangible object”. This definition was made in 1974. According to the definition, this also includes advertising material, and this has become a major source of income for the USPS. However, there are exceptions to the monopoly: “Letters accompanying cargo and letters of the carrier” and letters by special messenger and extremely urgent letters”. This has created a market for cycle couriers and express delivery. Other operators can deliver mail, but must charge twice as much as the USPS. The reasons for the monopoly on mailboxes are safety and the right to privacy. Nobody apart from the USPS may place mail in mailboxes, and all mail must be franked before it can be placed in a mailbox. PRC does not believe that this monopoly will disappear, although this has been discussed.

The foremost reason why the USA has a public postal system is the *Universal Service Obligation (USO)*. The USO means that everyone is to have access to mail delivery and reasonable distance to mailboxes and customer service. The definition also sometimes includes prices, six deliveries a week, and access to new products and services. The content of USO has changed over time. According to the USPS, the USO is a major cost, but PRC does not share that view. According to the PRC, approximately five percent of the annual income covers the cost of USO, and the cost is incorporated in the postal rates. PRC does not feel that liberalisation would affect USO.

Delivery and distribution

USPS domestic mail volume, which is falling, comprises approximately 73 percent non-bulk mail, of which approximately 64 percent is *First Class* mail. Examples of other classes are *Standard*, exemplified as advertising material, *Periodicals*, and *Priority*, which is First Class over a certain weight. As well as non-bulk mail, USPS also delivers packages. The USPS has only five percent of the package market, which is almost completely dominated by UPS.

⁴⁹ *Title 39 of the U.S. Code*

However, the market shares have increased in recent years, because of a bulk discount that was introduced in the 1990s. The increase only applies to delivery of packages, and not transport. Several of the competitors on the package market also use the USPS for delivery to the most isolated locations.

4.2 Worksharing discounts

In 1976 “*worksharing discounts*” were introduced. These are discounts for cost-reducing handling, whereby other companies are responsible for sorting and transporting post, and for operating some customer services such as *Mail Boxes Etc.* Mail Boxes Etc. functions as a post office and is part of the competitor USP group. Large companies and associated organisations felt that discounted prices should be available for large volumes, but the USPS initially opposed the idea. At first, discounts were only given for large volumes of First Class. However, worksharing soon applied to all classes, and not just large volumes but also cost-reducing handling in the form of pre-sorting and address coding of the mail.

Worksharing does not apply to the delivery stage, but only the preceding production stage. Today, the customers account for approximately 25 percent of the USPS value chain. Worksharing has also led to new companies starting up that specialise in preparing the mail for small companies, who cannot themselves reach the volumes that entitle them to price reductions. There are a number of different measures that a company can take to reduce costs - pre-sorting, pre-coding and transport (drop-shipping). To qualify for a discount on pre-sorting, the company must be able to enter the mail in one batch. Four different sorting levels bring different levels of discounts. Advertising material and periodicals have two more sorting levels. Pre-coding ensures that the mail items are given the correct street name, city, postal code (zip code) and state. If a company wishes to purchase this activity, its address register must have been run against the USPS register to confirm the correct residential address. Drop-shipping means that the sender transports the mail items closer to the recipients’ destination, so fewer production stages are used. First Class mail does not qualify for this discount.

In order to qualify for the discount, the company must be sending at least 500 items of bulk mail (First Class) or 200 items of advertising material. The more letters that are sent, the greater the discount, because greater volumes allow sorting at several levels. Approximately 250 different discounts are available, according to type of bulk mail, size, pre-sorting level, place where the mail is entered and coding. The discounts can range between 6 and 60 percent. Companies that use worksharing pay a fixed annual fee. Approximately half of all mail is currently handled through worksharing, and in 2003 the proportion was greater than the proportion of normal mail for the first time.

4.3 Pricing

By law, the USPS may not make a profit. Most of the costs are to be covered by income from postage, and Congress may only contribute with small amounts. The Postal Reorganization Act of 1970 introduced cost-based charges, with the re-

quirement that every post class should cover its own direct and indirect costs that occur in each class. Four hundred different costs are continually analysed.

Proposals for new postage charges are put forward when the USPS feels that the company will show a loss. As far as possible, the USPS tries to show costs for each service/class, but this is not always possible. Approximately 54 percent of the costs can be allocated to the correct class. Administrative costs are divided, but are mainly covered by First Class. After reviewing the costs, the board submits a proposal that is then passed on to PRC.⁵⁰ The proposal is presented together with a justification for increased prices, and an explanation of how the USPS has calculated the different levels. After receiving a proposal, the PRC has ten months to review it and submit a recommendation to the board. In this ten-month period, the USPS interviews customers, competitors and consumer representatives. If no recommendation is received within ten months, the USPS can temporarily apply new prices. After receiving recommendations from PRC, the board has several options:

- Accept the recommendation and apply new prices from a certain date
- Reject the PRC recommendations and return the proposal to PRC for further review
- Accept the recommendation under protest, and submit new price proposals to PRC
- Modify the decision through unanimous voting if the board feels that the new proposal does not generate sufficient profit.

4.4 Changes for the future

In 2002 a commission was appointed to review the USPS in view of its financial difficulties. The commission's task was to produce a report with recommendations about administrative and legal measures to assure the future of the USPS. The final report, submitted in July 2003, made the following recommendations:

- The USPS business model from 1970 needs to be changed.
- The USPS monopoly should be kept, at least in the short term.
- A *Postal Regulatory Board (PRB)* should be formed that would regularly review the monopoly. The PRB should review the USPS monopoly on the mailboxes, as there is no economic justification for this. The PRB would have greater influence than PRC currently has. The monopoly on delivery in the USA is not precisely defined, which gives the USPS great power. The monopoly on delivery should be clarified, and be as follows: *“Any hard copy communication that is to be conveyed and delivered to a specific address in the United States indicated by the sender, provided its*

⁵⁰ *The present commission is very consumer oriented, and tries to keep price rises in line with the Consumer Price Index (CPI). The postage cost for a normal letter has risen in line with inflation, while the worksharing cost has not shown the same rate of increase.*

weight is less than 12 ounces and the delivery price is less than the basic stamp price times six.”

- The USPS is to remain an independent public organisation.

The commission does not wish the USPS to be privatised at present, as this is regarded as being too risky and would destabilise the postal system. The commission does not feel that the private market could fulfil the USO in the way people are used to. Instead, the commission would like to see privatisation over a longer time perspective to smooth the transition.

According to the USPS nothing much has happened since the commission made its recommendations. A Congress proposal has been to introduce a “super-regulator” for greater monitoring of the postal system, but the USPS feels this would be a step in the wrong direction. The difficulties of passing a new reform are said to depend on the number of factors that must be considered, including pricing, the USPS workforce and the monopoly. The USPS has a large network, thereby incurring large costs. In combination with the strong unions, and the slow political process, this makes it difficult to change the system. The USPS feels that running the business as a commercial enterprise is difficult because changing the price structure is a time-consuming process. In contrast, the PRC feels that a liberalisation would benefit the American postal service, because the efficiency of the post offices needs to be improved, and the number of employees kept down. The PRC also feels that worksharing is one way to increase productivity and partly liberalise the market.

Debate is lively in the United States about the deregulation of the postal market. The monopoly is seen as a disadvantage, because the USPS has a monopoly on the delivery of mail, yet operates on a competitive market for packages and express mail. This creates a situation where the USPS can use profits from the activities where there is a monopoly to subsidise activities on the competitive market. Cross-subsidies are prohibited by law, and each mail class must cover its own costs. The status of the USPS as a federal authority entitles it to tax exempt status. Furthermore, the USPS can take interest-free loans from the state, does not need to pay dividends, and cannot be declared bankrupt. A number of observers feel that these factors do not create competition neutrality. According to observers, other problems are high salaries, an excessive workforce, low productivity, and the fact that raising the postage rates is too simple.

In summary, the pricing seems to be relatively adapted to costs, because of the pricing procedure in combination with the use of worksharing discounts. Price trends seem to be in line with inflation. However, the absence of competition restricts productivity improvements and the development of new services. Another problem is that of competitive neutrality in related markets. Finally, the system gives a bureaucratic impression, especially the time-consuming procedure for pricing postage. The regulator estimates the cost of the USO to be five percent of the USPS annual income, but then it must be remembered that delivery is made six days a week over the entire country. With a more flexible USO, the costs would probably be considerably reduced.

5 Conclusions

5.1 Summary of developments on the Swedish mail market

Introduction

It is important to take a *what-if* approach when evaluating policy measures such as the deregulation of the postal market. In other words, what would have happened if the policy measure had not been implemented? It is impossible to know what the situation would have been if Postverket had retained its monopoly on the postal market. There is a risk that all changes, positive as well as negative, are linked with the deregulation. This report provides an economic analysis of changes on the postal market and an evaluation of whether the goals of postal policy have been attained. Economic efficiency refers to price changes, adaptation to underlying costs and productivity development.

Deregulation of the Swedish mail market is unique since no other country has yet implemented a comprehensive policy of liberalisation in this area. Finland has formally deregulated its market, but the application of licensing fees to guarantee the provision of USO constitutes a substantial barrier to entry, so competition has not grown. Trends in the Swedish mail market over the last decade are thus the only empirical example. This report shows that many more or less accepted truths are brought into question by developments in Sweden. This applies not least to the issue of natural monopolies and whether a monopoly is necessary in order to guarantee a Universal Service Obligation (USO). This is frequently asserted by national postal services, as well as by researchers, whose own research is often funded by these bodies.

The goals of postal policy

In terms of quality of mail delivery, independent surveys have shown that 95.7 percent of all mail handed in for overnight delivery was delivered the following working day, and 99.8 percent within three working days. The number of addressees not receiving mail delivery on a daily basis has decreased between 1990 and 2002. This concerns approximately 1,200 households and the majority of these are located in isolated mountainous regions or in the archipelagos. Requirements regarding service and quality according to these central criteria seem to be satisfactorily fulfilled, and deregulation has not had a negative impact.

According to the latest Swedish study, the additional costs of USO amount to SEK 100 million per year. A recent study by the Norwegian postal service estimates the costs of USO to be two percent of sales. This cost could be removed if the USO was applied more flexibly, such as by withdrawing Saturday delivery. Neither of the studies made allowances for the income produced by being the only nationwide operator in each country, which naturally increases profits. The American supervisory authority, the *Postal Rate Commission*, has calculated that around five per-

cent of the annual income of the U.S. Postal Service covers the cost of the USO. In the United States, there are six deliveries a week. Swedish Posten does not regard USO as a burden; quite the opposite in fact, as it considers that serving all addresses in Sweden gives a competitive advantage. Posten also has a commercial interest in fulfilling the goals of postal policy.

One regional aspect in this context is how the service network for mail and package services has changed since deregulation. Major restructuring of the service network since 2001 substantially reduced the number of traditional post offices. However, the number of service centres (in shops), run on an outsourcing basis, has increased substantially, and so the total number of service centres is the same as at the end of the 1980s. However, it should be noted that this change started as early as 1989, i.e. before deregulation. The change is mainly in response to falling demand for postal counter services over a number of years. Since restructuring, the number of service centres has mainly increased in densely populated areas, while the number of such centres in sparsely populated and rural areas has fallen. This has been offset by Posten increasing the number of rural postal delivery rounds.

According to the preparatory policy documents, the objective of postal policy was to ensure that the needs of citizens and society were met by an efficient and reliable postal service. Given the background above, the objective of postal policy can be said to be satisfactorily attained.

Market trends

The major distinction to be drawn on the mail market is between bulk mailings, also known as industrial mail, and post office mail or mailbox mail that is delivered as individual items. Bulk mail is defined as large numbers of mail of the same weight and format that is often handed in pre-sorted by postal code by the customer. Consequently, various product descriptions, such as addressed direct mail, letters and magazines, are unimportant in this context. These are merely descriptions of the content. The conditions for competition, as well as actual competition, and price and market trends, vary significantly between the segments for bulk mail and individual mail, so they are regarded separately.

The total volume on the mail market has been relatively constant over the last decade. In the segment for bulk mail, both addressed direct mail and economy mail has increased in volume. The major growth has been in the ODR (non-addressed direct mail) market. The segments that are decreasing are bulk mail delivered overnight and individual mail, which in principle comprises First Class (*A-brev*) mail. It is primarily in the last category where competition from other forms of communication has had an impact and affected volumes.

In our view, the mail market has some of the elements of a natural monopoly. However, this does not apply to certain stages or parts of the production process, but only to the segment of individual mail and especially to the overnight nationwide delivery of mail. In the United States, the complete production chain is not regarded as a natural monopoly, since customers can take cost-reducing measures for mail delivery at an earlier stage. It should be emphasised that the term “natural mo-

nopoly” is not static. Changes in demand and cost factors, the growth of substitutes, as well as innovations and technical advances can change the view of what is regarded as a natural monopoly. On the other hand, the future mail market will probably not be characterised by a large number of significant operators, and is expected to resemble an oligopoly market. Free competition is not a realistic model.

Based on overall market shares, Posten still has a very strong position. The company has about 90 percent of the segment for bulk mail, while in principle it has an actual monopoly in the segment for individual mail. Posten is the only nationwide operator. The next largest operator, CityMail, delivers mail in the three large metropolitan areas and Gotland, and serves just over 36 percent of addressees in Sweden. CityMail specialises in and focuses on the segment for bulk mail or industrially-produced mail. The company's share of this segment is estimated at about 10 percent. The other 26 players are small companies engaged in local postal activities. In the segment for bulk mail, CityMail faces relatively strong competition in relation to the company's market share. It is largely competition from CityMail that has affected Posten's price structure and pricing.

The competition, mainly from CityMail, has also led to new innovations and improvements in the market. The entry of CityMail to the market provides an excellent empirical example of how competitors can challenge a former monopoly. The company's business concept is based on customers using new technology to sort mail by postal code in their production stage, and prepare it for efficient handling, at no additional cost. The business is also structured in a completely different way to Posten and other national postal operators handle production. CityMail only distributes mail, although the company is responsible for the entire distribution chain. CityMail has high productivity in the distribution phase, and can compete with Posten by only delivering once every three days in a given area. This is an adaptation to changing customer demands, and this has also been hastened by the company's entry into the market. Many customers demand not just rapid distribution, but also value reliability and delivery on a predetermined day. Svensk Adressändring (handling change of address, mail forwarding, etc) was also introduced by CityMail. Today the operators share influence over this service, which is regarded as part of the common infrastructure.

In an analysis of changes since deregulation, mention must be made of the legal disputes about competition, which were common in the 1990s. These disputes are often long and drawn out, and usually have a greater effect on smaller players since they have fewer personnel and financial resources compared with the dominant company. This weakens their staying power. These disputes, coupled with a lack of regulation under the earlier system, have restricted the development of competition. The Swedish Competition Authority has played an important role in the development of the mail market, and reflects the importance of the special attention paid by the competition authorities to deregulated markets. The Competition Authority could perhaps have acted more forcefully during the first half of the 1990s. The Market Court in 1998 ruled that Posten, during a certain period, had intended to eliminate competition from CityMail.

The decision of the Market Court and the amendment of the Postal Services Act in 1999 clarified the specific terms for the mail market. The revision regulated by law postal operators' access to the joint infrastructure. In recent years the conditions have normalised, at least when it comes to the cases examined by the Competition Authority.

The Government goal for deregulation was an increase in competition that would stimulate the development of new and better methods of mail delivery to the benefit of the consumers. Although this has happened, it must be pointed out that important prerequisites for this were lacking in the original Postal Services Act. At the same time the State, through its company Posten, took measures to restrict competition during a certain period. Posten' actions are ultimately determined by its owners and the board.

Economic consequences

Analysis of pricelists alone gives an inaccurate picture when describing changes in the mail market since deregulation. This is because most mail is priced through agreements with individual customers, agreements that often entail significant discounts.

A more accurate picture can be obtained by studying how operating income per mail item has changed in the Posten business area previously known as "Brev". Average operating income per addressed mail item has increased by 25 percent in nominal terms during the period 1994-2003. Allowing for inflation, which was about 12 percent during the period, this leads to the conclusion that average income has exceeded price increases by 13 percent.

Prices for individual mail items have increased by 30 to 50 percent since deregulation. Since average income has increased by 25 percent during the same period, this means that increases in the price of bulk mail have been smaller. There has been a shift in volume from more expensive individual mail to bulk mail, which may have had an impact on income trends. This situation has been accentuated by the fact that Posten has chosen to apply lower prices to bulk mail, which is also a response to costs and competition.

Prices have therefore become more closely linked to costs, and in the segment for bulk mail have probably approached marginal costs. Such pricing is economically efficient and deregulation has led to socio-economic gains in this respect.

It is usually claimed that improvements in efficiency and productivity of Posten, after the end of the monopoly, is one of the major benefits of deregulation. There was a major improvement in productivity for Posten Brev around 1993/94, when productivity increased by nearly 20 percent in terms of the volume of addressed mail delivered in relation to the number of annual employees. Between 1993 and 2000, productivity increased by a total of 32 percent. Productivity in recent years has stagnated, but there are no comparable figures available for these years. A contributory factor to poor development of productivity in recent years may be that the volumes of ODR per annual employee have doubled over this period. Joint pro-

duction of ODR and addressed mail does not only give advantages; it also limits the potential for improving the efficiency of Posten's distribution organisation.

In itself, it is not surprising that changes in productivity can be observed during the period referred to above, because productivity in most industries increased. However, the rapid improvement in 1993/94 can largely be attributed to deregulation and the transformation of Posten into a commercial company, which took place at that time.

The economic objectives of deregulation, i.e. efficient mail delivery, can also be regarded as attained. Prices are more closely related to costs, and the prices of segments exposed to competition are probably in line with marginal costs. Moreover, productivity of the dominant players improved, mainly in the initial stages. However, average price increases have exceeded inflation since 1994, while changes in recent years are in line with inflation. If changes in prices are instead compared with the increase in labour costs during the same period, price changes are roughly in line with cost increases when the productivity increases achieved are taken into account. Productivity improvements in Posten thus appear to have benefitted consumers in general. Finally, it can be added that service content has improved and adapted to the changing demands of customers. Overall, this means that the Swedish mail market is probably one of the most efficient and most developed in the world, and this can very largely be attributed to deregulation.

5.2 Action scenarios for the future

When considering possible changes in the current regulatory framework, the positive trend in the Swedish mail market should be taken into account. Sweden is ahead of other countries in this field, so little can be learned from experiences from other countries. Sweden has chosen its own path and so changes should only involve minor adjustments to the regulatory framework and its application. The single most important factor is the growth of competition, especially from CityMail. It is therefore of the utmost importance that at least one powerful competitor to Posten remains in the market. There is no other single factor in the regulatory framework that is of such importance, even though the regulatory framework promotes competition. The overall objective of deregulation was to achieve a more efficient mail market. The number of operators is not the crucial factor; more important is how efficient they are, and how much competitive pressure they are able to exert on the dominant player. It is not simply a matter of competition for the sake of competition.

In this report we have found that deregulation has not posed a threat to the fulfilment of the Universal Service Obligation. The obligation entails negligible additional costs, and it is a competitive advantage for Posten to have access to a nationwide delivery organisation. Posten remains the dominant company and so it will naturally continue to be required to guarantee the fulfilment of the USO in accordance with its licensing terms. No circumstances have emerged that indicate any need to change that situation at present. It should be noted that the implemen-

tation of concessions and licensing fees in Finland has created barriers to entry that have prevented competition.

The study shows clearly that the Competition Authority has played an important role in shaping the market. Since the market is not yet fully developed, the Authority should continue to devote special attention to the mail market, as well as other deregulated markets where competition is fragile. It is also important that the Authority continues to work closely with sector authorities, since competition issues are often complex and require specialist knowledge of such areas as cost accounting and principles for allocating costs.

The conditions regarding the price ceiling on postage for individual mail are largely unchanged from when the Postal Services Act was introduced in 1994. In the segment for individual mail, Posten has a virtual monopoly. The nature of the competition in the future is impossible to forecast. The groups that may be vulnerable are not just private persons, but also companies that do not attain the required threshold volumes for bulk mail pricing. These senders of individual mail must still be protected from excessive price increases, as they have no alternative to Posten for mail delivery. If not, Posten is in a position to exact monopoly profits. As emphasised in the Bill, a price ceiling reduces the risk of using services not exposed to competition to cross-subsidise services that are exposed to competition.⁵¹ A price ceiling would pose no threat to Posten's profitability and, according to Posten, overnight delivery is profitable on the whole. It is assumed that prices of individual mail should be based on costs, but, according to PTS, there is currently no documentation on which to determine whether this is the case. It is desirable that PTS has this information in the future so that such an assessment can be made. At present, there is therefore no reason to change the price ceiling.

⁵¹ *Bill 1993/94:38*

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Appendix: Referral comments on the final report of the Swedish Postal and Cashier Service Commission: The Changing Postal Market (SOU 2005:5)

The Postal and Cashier Service Commission requested that the Swedish Institute of Growth Policy Studies (ITPS) conduct a broad economic analysis of the liberalisation of the postal market, and certain parts of the Commission's Final Report, particularly Chapter 5, are based on the ITPS report, which is annexed. The report finds that:

“The economic objectives of deregulation, i.e. efficient mail delivery, can also be regarded as attained. Prices are more closely related to costs, and the prices of segments exposed to competition are probably in line with marginal costs. Moreover, productivity of the dominant players improved, mainly in the initial stages. However, average price increases have exceeded inflation since 1994, while changes in recent years are in line with inflation. If changes in prices are instead compared with the increase in labour costs during the same period, price changes are roughly in line with cost increases when the productivity increases achieved are taken into account. Productivity improvements in Posten thus appear to have benefitted consumers in general. Finally, it can be added that service content has improved and adapted to the changing demands of customers. Overall, this means that the Swedish mail market is probably one of the most efficient and most developed in the world, and this can very largely be attributed to deregulation.”

The considerations and proposals offered in the final report do not mean any more radical changes in the regulations, but rather minor changes that will facilitate a continued favourable development of the mail market. ITPS generally agrees with the direction of the Commission, which coincides with ITPS's recommendation in its report to primarily make minor revisions to the regulations and their application.

ITPS, however, wishes to especially emphasise the following views:

ITPS shares the view of the Commission that a sector-specific regulatory system that would give other operators access to parts of the network of the dominant operator is too extreme and administratively cumbersome a measure. However, the Commission's proposal for non-discriminatory pricing and conditions for certain customers is an efficient measure that helps to increase pricing transparency and precision.

The Commission proposes that the price ceiling be abolished. Although ITPS found in its report that there was no reason to change the price ceiling, that conclusion reflected the fact that there is currently no documentation that would enable a determination whether the price of individual mailed items is based on cost.

Removing the price ceiling would thereby contribute to an increased risk of cross-subsidisation between competing and non-competing services, and especially between bulk mail and non-bulk mail.

The Commission proposes that price regulation should be abolished at least six months after the proposed amendments of the Postal Services Act enter into force. According to the Commission, it will require additional time before the Postal and Telecommunications Board (PTS) begins to apply the new provisions on clear and precise pricing and anti-discrimination to such an extent so that they would provide adequate protection against cross-subsidisation. ITPS wishes to emphasise the absolute importance of conditioning the abolition of price regulation on this reservation. If this condition is satisfied, ITPS supports the change, as price regulation should be avoided as far as possible.

Finally, the proposal for new postal policy goals gives an uncertain impression. ITPS questions whether it will be possible to follow up the goal that “Postal services should be sustainable and adapted to customers and the needs of the future.”

This decision has been made by the undersigned. The matter was presented by Björn Falkenhall.

Sture Öberg
Director-General

The Swedish Institute for Growth Policy Studies (ITPS) is a Government Agency responsible for providing policy intelligence to strengthen growth policy in Sweden. ITPS primarily provides the Government Offices, Members of the Swedish Parliament, other state authorities and agencies with briefings based on statistical material, policy papers and key analyses. Business policy and regional development policy are areas given high priority.

Changes in policy should be based on:

- Statistic data and analyses of the structure and dynamics of industry – to obtain an up-to-date view of future challenges and opportunities.
- Evaluation of results and effects of policy measures and programmes – to provide benchmarks and learn from measures implemented earlier.
- Policy intelligence in order to look outwards and ahead – what issues are likely to come on the growth policy agenda in the future?

These represent the principal missions of ITPS.

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