

COMPETITION AND INNOVATION IN POSTAL SERVICES

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INTERNATIONAL POSTAL REFORM: An Application of the Principles of Rowland Hill to the International Postal System

James I. Campbell, Jr.

Cheap postage! What is this men are talking about? Can it be that all my life I have been in error?

—Sir Francis Freeling, Secretary, British Post Office (Harlow 1928, 190)

Although many nineteenth century figures are better known than Rowland Hill, few had a more beneficial effect upon civilization. His thoughtful analysis of the British Post Office resulted in the establishment of the first inexpensive, universal system for communications available to all members of society. Modern post offices allude romantically to Persian messengers and Roman couriers, to seventeenth century proclamations and ringers of bells in cockaded hats. But these allusions are fundamentally misleading to the modern mind. What we think of as postal service began in 1840, a magnificent English innovation soon copied by all countries in the world.

Modern postal service has become so commonplace that we forget its significance. We take for granted—indeed we can hardly cope with—the possibilities of cheap universal communications. To appreciate the work of Rowland Hill we must imagine a world without telecommunications, when one's only connection to the outside world was by the physical delivery of messages and newspapers. In overall social importance, the development of cheap, universal postal service was as significant in its way as more technologically spectacular inventions such as the telephone and television.

The essence of Hill's approach was, I believe, that he refused to accept the correctness of traditional assumptions about the postal business or yield to political "realities." Rather, he thought through his ideas logically and carefully and forced his opponents to do the same. Today, discussions about postal policy on both sides of the Atlantic are replete with statements such as "You may be right, but of course

we must recognize political facts of life." The first lesson that I take from Rowland Hill is that governmental and industry officials—whether in Brussels or Washington or anywhere else—must concentrate their attention upon the truth, not political realities, if they are to earn what Hill nicely refers to as "the gratitude and affection of the people."

For me, it is interesting to speculate what would have happened if Hill's proposals had been rejected and the British Post Office left unreformed in 1840. Perhaps Rowland Hill would have started a private delivery company to put his ideas in practice. Of course, Hill Express would have started on a small scale. From the beginning, however, Hill would have introduced prices based upon actual costs, so that delivery rates between major cities would have been uniform. And he would have simplified procedures such as prepayment of charges, elimination of unnecessary supervisory work, expedited delivery procedures, and so forth.¹

No doubt the British Post Office would have tried to close Hill Express for violating the postal monopoly. Having proven his ideas on a small scale, Hill would likely have argued his case to Parliament. The Post Office would have surely replied that Hill Express was "cream skimming" the most profitable routes, taking advantage of anomalies in postal tariffs, and failing to provide the traditional security measures. Scholars and experts would have been invited to comment about whether Hill's ideas would be viable for the entire postal system. And the Post Office would have noted that in any social situation, there are so many variables that it is impossible to prove that disasters will not occur if conditions change.

Perhaps. But, of course, all of this is mere speculation. I raise it only by way of prologue.

Despite the general acceptance of most of Rowland Hill's ideas, several participants in the conference question whether national postal policies have applied fully Hill's teachings or, indeed, whether they comply with still more esoteric economic criticisms. Rather than push into this crowded field, I would like to place before you the suggestion that there remains a most interesting and important realm of postal policy which is almost completely unenlightened by, and is quite ripe for, Rowland Hill's reforms. I am referring to the international postal system.

To give you a sense of scale, the United Kingdom postal system in Hill's day transmitted an estimated 126 million items. The international postal system of today handles about 6.4 billion items (excluding the Soviet Union), about 50 times as many. In 1837, the fastest coaches from London to Edinburgh took about 60 hours. Today, air transportation from London to Sydney takes about 24 hours. In operational terms, then, the international postal system is substantially denser and more compact than the British postal system of 1837. Compared to today's national postal systems, the international postal system is about the same size as the Italian post office, and a bit smaller than the Canadian.

I would like to suggest to the conference a few simple propositions about the international postal system: (1) it has never embraced the basic reforms of Rowland Hill; (2) it is extremely important in overall commercial and social development;

and (3) it presents a postal system in which fundamental reform is feasible and especially timely.

To support my suggestions, I shall examine seven aspects of current international postal policy using Hill's famous 1837 paper (Hill 1937) as my basic text, with annotations drawn from the experience of the private international express industry. I do not intend my comments to be definitive in a scholarly sense; on the contrary, my purpose is to experiment with these ideas, to offer hypotheses, and to encourage further analysis by others more qualified than I.

1. Relatively Poor Performance of International Postal Sector

Hill began his study of the British Post Office by asking "whether its productiveness has kept pace with the increasing numbers and prosperity of the nation." He noted that, in the preceding two decades (1815-1835), population had increased by 31 percent whereas postal revenues had actually declined by 1 percent. He found this particularly remarkable considering that revenues from the stagecoach tax, a seemingly closely related industry, had increased by 129 percent (Hill 1837, 2-4).²

The circumstances of the international post today are remarkably similar, at least to the untutored eye. According to estimates by the Universal Postal Union³ (UPU), during the last decade (1977-1986), the volume (pieces) of international letters (LC) handled by the 28 major non-communist post offices decreased by 6 percent and the volume of printed matter (AO) increased by only 4 percent. This poor performance contrasts with increases, during the same period, in domestic postal traffic of 32 percent for letters (LC) and 68 percent for printed matter (AO). Like Hill, we can look to seemingly related industries for confirmation that something is amiss. During the same decade in which international postal traffic stood still, international aviation (world passenger kilometers) and international telecommunications (telephone calls between the European Economic Community (EEC) and the United States, both directions) grew by almost 100 and 500 percent, respectively. These figures are summarized in table 1.

It should be noted that the relatively poor performance of the international post is in no way explained by the recent phenomenon of remail. Since remail is by definition eventually posted somewhere, a loss in one post office's account will show up as a gain in another post office's account, not affecting the total.⁴ Moreover, remail of letters did not develop to any substantial degree until after 1986, the year the United States Postal Service withdrew objections to international remail based upon the United States postal monopoly.

According to Hill's approach, then, it would appear possible that the international postal system has failed to keep pace with modern commerce and may be in need of fundamental reform.

Table 1. Relatively Poor Performance of the International Post			
	1977	1986	Change
Intl Post (OECD)			
Letters (LC) bil.	3.9	3.7	-6%
Printed (AO) bil.	1.3	1.4	+4%
Domestic Post (OECD)			
Letters (LC) bil.	107.8	142.5	+32%
Printed (AO) bil.	64.6	108.3	+68%
Intl Aviation (World)			
Sched. mil. tonne-km	46.7	89.6	+92%
Intl Telecomm (US-EEC)	36.6	219.3	+499%
Sources: UPU, <i>Five-yearly Report on the Development of the Postal Services, 1977-1981</i> , Tables XIV, XV, XVIII, XIX (1984); UPU, <i>Five-yearly Report on the Development of the Postal Services, 1982-1986</i> , Graphs T1, T4, T13, T16 (1989); International Civil Aviation Organization, <i>Civil Aviation Statistics of the World</i> , Table 1-13 (1986 ed, 1988 ed.); U.S. Federal Communications Commission, <i>Statistics of Common Carriers</i> Table 15 (1977 ed.), Table 13 (1986 ed.).			

2. Division of Distribution into Primary and Secondary Areas

The second step in Hill's analysis was an intuitive simplification. He divided the business of the Post into "primary" and "secondary" distribution systems. "Primary distribution" was defined as distribution within and between major towns. "Secondary distribution" included distribution "to towns of inferior importance, and to country places." According to Hill's (1937, 10-13) calculations, primary distribution accounted for about 61 percent of the whole (by revenue). The reforms advocated by Hill pertained mainly to the primary distribution area.

At the governmental inquiry into Hill's proposals, Hill himself was followed by two witnesses from the Post Office. The first said he did not understand the distinction between primary and secondary distribution, and the second testified that he understood it and saw no advantages. Finding the concept too technical to explain in the face of postal opposition, Hill withdrew this portion of his proposal (Coase 1939, 423, 432). Writing a century later (1939), Professor Coase (1939, 435) commented:

There is indeed good reason to deplore the abandonment of the distinction between primary and secondary distribution. It ... might have led to a rational discussion of price policy and its relation to costs. As it is, the magic word "uniformity" has been substituted for thought.

Most, I think, would agree that Hill's distinction between primary and secondary distribution remains an economically sound idea.⁵ The analogous approach in the international area is clear. Of total international mail, about 80 percent circulates between the developed countries.⁶ Hence, as in England in 1840, it is possible to improve the entire system by concentrating on primary distribution. In the international postal system, we may tentatively define the primary distribution system

as including all traffic among the 24 OECD countries or the UPU's similar list of 28 "free market industrialized countries."

Of course, dividing the world into "big guys" and "little guys" is not automatically popular. Indeed, as recently as 1979, the UPU explicitly rejected a carefully reasoned proposal to divide the "terminal dues" charge into a two tier system which distinguished between developed or less developed countries.⁷

Recent events in the international postal world, however, suggest the growing acceptability of such an approach in two key areas. First, the 1989 UPU congress made a U-turn and agreed to a two tier terminal dues system. Second, about 20 major post offices have decided to coordinate postal policy more closely under the umbrella of a Dutch company called Unipost.

It should be noted that in both cases, the international postal system's embrace of this Rowland Hill concept has come entirely by way of reaction to the competition posed by the private express system.⁸ As we shall see, this is not the only instance in which competition has forced the international postal system to rediscover Hill's principles.

3. Adaptation of Price to Cost

After his grand division of the postal system into primary and secondary distribution, Hill analyzed postal costs guided by the principle that prices should reflect actual costs (plus a uniform tax in Hill's day).

The most famous application of this approach was Hill's advocacy of a uniform postage rate within the primary distribution area. Prior to 1840, British postal rates varied according to distance and a host of other transportation factors. Postal historian Alvin Harlow (1928, 180-181) writes:

[I]n 1813 and thereafter, the city [of London] rates were twopence and threepence, and the weight limit four ounces. There were numerous surcharges throughout the kingdom. For example, a single letter of one quarter-ounce weight going from London to Dublin, about three hundred and twenty-five miles, paid one shilling fourpence [24 pence] of which twopence was steamer postage across the Irish Sea from Holyhead, one penny for crossing the Conway Bridge and another for crossing Telford's bridge across the Menai Straits... The general result was that the post had become a convenience only for the well-to-do, and that even they avoided the payment of postage whenever and by whatever means possible.

Undaunted by this seeming complexity, Hill carefully examined postal costs in the primary distribution area and concluded that, contrary to conventional wisdom, the cost of transportation between major towns was an insignificant fraction of the total cost of delivery. For this reason, Hill argued, the postage rate "must be uniformly the same from every post town to every other post town in the United Kingdom" (Hill 1837, 16).

Because of frequent misstatement of Hill's principles today, it is worth emphasizing that uniformity of price was simply a consequence of conforming prices to costs, not a goal in itself. Hill did not advocate uniform postage rates to

secondary towns, for he saw clearly the economic error of such an approach and believed that “every branch of the Post Office ought to defray its own expenses” (Hill 1837, 46). We might summarize Hill’s views of secondary distribution by saying that the institutional costs of the post office should be borne by the primary distribution system while secondary distribution costs should be tailored to the needs of individual communities and priced at marginal cost (Hill 1837, 46-48).⁹

Given the subject of my paper, Hill’s views on international postage rates are especially interesting. He wrote (Hill 1837, 48):

For the sake of simplicity in accounting for postage, it is very desirable that the rates of charge should be the same for Foreign and Colonial as for Inland letters; that is to say, that a Foreign or Colonial letter not exceeding one ounce in the British Isles should be conveyed from any post town in the British Isles to the Foreign or Colonial port [emphasis by Hill] for one penny. *The conveyance in the foreign country or colony being of course subject to the arrangements there established* [emphasis added].

Hill’s insistence on conforming price to cost also led him to advocate abolishing postage rates for “packets” which depended upon the number of sheets of paper in the envelope. Hill (1837, 17) reasoned:

Again, the expenses of receipt and delivery are not much affected by the weight of each letter, within moderate limits; and, as it would take a nine-fold weight to make the expense of transit amount to one farthing [one quarter penny], it follows *that, taxation apart, the charge ought to be precisely the same for every packet of moderate weight, without reference to the number of enclosures* [emphasis by Hill].

Thus, Hill’s basic principle that postal prices should reflect costs may be seen in three pricing policies. We can restate them as follows: (1) the cost of transportation between large cities does not vary proportionally with distance and is small relative to collection and delivery costs; (2) postal charges for delivery in a foreign country should be based upon the cost of delivery by the foreign post; and (3) postal charges for shipments of multiple letters handled as a single shipment should be based upon cost factors and not simply the number of letters.

Let us consider the international postal system in regard to each policy.

3.1. Charges for International Transportation

While many post offices contract individually with international carriers, the matter of correctly costing international transportation comes up when post offices forward each other’s mail, either to another post office or to a city removed from the port of import. For example, what should the French post office charge the British Post Office for transporting English mail from Calais to Germany? Or from Calais to Lyons? In UPU terminology these charges are called “transit charges” and, for air transportation, “air conveyance dues.”

At the very first congress of the Universal Postal Union in Berne in 1874, the matter of “transit fees” occasioned the “longest and most acrimonious discussion” (Coddington 1964, 29). Some post offices argued there should be no charge for

forwarding mail, citing Rowland Hill, who of course would never have supported such a thing.¹⁰ Other post offices, who were so situated that they had large amounts of transit mail, insisted upon being repaid (or better, overpaid) for costs incurred.

In the end, the twenty one predominately European countries agreed upon a common transit fee schedule under which transit charges varied depending upon weight, distance, type of conveyance, and the nature of the mail. Table 2 presents the figures.

Table 2. First UPU Transit Fees (1874)		
Distance and Means	Letters (LC)	Printed Paper (AO)
0-750 km by land	2 gf/kg	0.25 gf/kg
750+ km by land	4 gf/kg	0.50 gf/kg
0-300 n.mi. by sea	0 gf/kg	0 gf/kg
300+ n.mi. by sea	6.50 gf/kg	0.50 gf/kg
Europe to U.S./India	Negotiated	Negotiated
Source: Codding (1964, 29-30).		
Note: "gf" refers to gold francs; "n.mi." refers to nautical miles.		

It requires no special knowledge of nineteenth century economics to recognize this as a political solution rather than the economic one that Rowland Hill would have advocated. It seems highly likely that a 20 kilogram bag of letters costs a little more to transport by ship than a 10 kilogram bag; in any case, the sea voyage for a bag of letters was certainly not 13 times as costly as for a similar bag of newspapers.

Today, UPU transit charges, and air conveyance dues, still vary according to weight and distance, even though the costs of transport tend to vary more by volume and number of pieces.¹¹ Moreover, unlike the UPU of 1874, the modern UPU convention makes no allowance for variations in cost around the world. The same schedule applies to America and India as to France and Germany.

Within the last two or three years, however, the outbreak of international remail competition between post offices, aided by the private express industry, has caused some post offices to reconsider this inflexible and cost insensitive approach. A 1987 UPU "Study on Remailing" notes:

*The remail firms' flexibility in obtaining favorable air transportation rates is another major competitive advantage they have over postal administrations. For longer distances they pay air freight rates which are much lower than UPU conveyance rates. For shorter distances, where the UPU air conveyance rates are comparable to, or even lower than, air freight rates, they submit their mailings to a postal administration which is willing to cooperate by dispatching the items as its own mail, at the usual UPU air conveyance rate.*¹²

At the UPU congress last December, the Secretary General acknowledged the assistance of the private express industry in bringing this matter to his attention

when he described the situation to the man from IATA (International Air Transport Association) as "the onslaught of the competition."¹³

Despite recognition that air transportation charges (the most important transport element today) do not reflect actual costs, the UPU Executive Committee has so far rejected proposals either to move to individually negotiated arrangements or to accept a slightly more cost related ("digressive") air conveyance schedule.¹⁴

3.2 Charges for Foreign Postal Delivery

Delivery of mail in a foreign country, Hill thought, should be "subject to the arrangements there established." However, the UPU has never accepted this Hill precept either. Indeed, the UPU's approach has been exactly the opposite. The basic principle of the UPU has been that British mail should be delivered in foreign countries, from Afghanistan to Zimbabwe, for the delivery cost incurred by the British Post Office in England! Put another way, the UPU's basic premise has been that the mail flow between two post offices is the same in both directions, in quantity and content, and that delivery costs are the same in both countries; as a result, neither post office would charge the other for local delivery.

In the UPU's 1897 Washington Congress, some post offices noted that they received more mail than they sent out. At the 1906 Rome Congress, the Italian post office demonstrated that it delivered 320,000 printed papers from abroad and sent out none. It was not until 1969, however, that the UPU introduced a correction for traffic imbalances. The correction charge, called "terminal dues," was a fixed amount per kilogram.¹⁵

This uniform, weight based delivery terminal dues charge, however, is fundamentally flawed. Most basically, it applies equally to all post offices, despite the fact that, according to a 1988 UPU survey, actual local delivery costs around the world vary by a factor of 16 or more (depending upon LC or AO).¹⁶ One can just imagine Rowland Hill shaking his head in amazement!

A second problem with the terminal dues rate is that it ignores the number of pieces of mail, even though local delivery costs obviously vary more by number of pieces than by weight. The 1989 UPU Congress finally addressed this second issue, but only halfway. It set different per kilogram charges for letter mail (LC) and printed matter mail (AO) based upon the assumption that there are 46 letters and 5.6 printed papers in each kilogram of mail.¹⁷

This limited reform was the direct result of the "problem" posed by remail competition. The problem with remail is that large mailers can use the private express system to shop among post offices, tendering their mail to those post offices that reduce international postage rates to marginal costs. Since terminal dues are the major component of marginal costs for international mail, the post offices agreed to raise terminal dues among themselves as much as possible.

Spurred by the competitive threat, some post offices have gone even further, embracing an approach very much like Rowland Hill advocated in 1837. These post offices are prepared to levy a charge for the delivery of foreign mail based upon the domestic postage rate. The domestic rate is discounted by a percentage,

about 40 percent, reflecting the absence of collection costs for foreign mail. This system has been operating among the four Nordic post offices since the first of January, 1990, and I understand other European post offices may be negotiating similar arrangements. Indeed, as a result of a complaint filed by the International Express Carriers Conference, the European Commission may soon rule that some such approach is required in the European Community. If the Commission so rules, I have no doubt the international postal system will be the better for it.

3.3. Discounts for Packets of Letters

Unlike the British Post Office of the 1830s, the modern international postal system has never charged for the transmission of letters based upon the number of sheets per envelope. But it has done something similar. For letters collected at a single point—a post office or sender's office—the collection cost is more or less the same for one letter or for many letters. Yet the international post has traditionally been very reluctant, more so than the national post, to allow discounts for large mailers who save the post office collection costs.

Again, we may note that, in the last two years and in response to private competition, the international postal system has lowered prices for large mailers. A 1988 UPU survey found that 88 percent of responding post offices had accepted the need to lower prices.¹⁸ Indeed, there is a danger that the international postal system will reduce prices to predatory levels. New Article 12bis of the 1989 UPU Convention authorizes post offices to

give preferential rates to major users [not less than] those applied in the internal service of items presenting the same characteristics.

A quick reference to Rowland Hill suggests to me that this provision would allow a relatively low (unit) cost postal administration, such as the Royal Mail or United States Postal Service, to reduce international postage rates to well below actual cost.¹⁹

4. Simplification of Postal Operations

A fourth major theme of Hill's review of British postal operations emphasized the gains to be won from simplifying operations and procedures. He analyzed the inefficiency of letter carriers collecting postage. Hill also described in detail the complicated clerical work demanded by the old tariff, requiring "a vigilance rarely to be met with." And he lamented the large number of supervisors necessary to guard against fraud. These observations led Hill to recommend, among other things, that all postage be prepaid and that the number of "receiving-houses" be expanded.

Today, hardly any international mailer is aware that postage used to be collected from the addressee, but there are still somewhat similar anachronisms to be found. For large international mailers, for example, the traditional method of paying postage is very cumbersome. Postage must be calculated on an individual piece basis and affixed to each letter. And the prepayment of foreign postage for business

reply cards was impossible. Private express companies, however, introduced the possibility of paying for large mailings of similar items on the basis of total weight. Shippers could accumulate charges and pay against monthly invoices, as with most other businesses. Prepaid international business reply cards were also introduced. Such simplified payment procedures are in fact quite important for large customers. Here again, the international postal system has been forced by the competitive threat to introduce similar features, to the benefit of the mailers.²⁰

5. Postal Management and Postal Monopoly

Overall, Rowland Hill was not favorably impressed with the quality of management at the British Post Office. He wrote (Hill 1837, 40):

The Post Office has too generally lagged behind other institutions in the progress of improvement, instead of being, as it might be, an example to the country of skilful and energetic management.

Hill's 1937 paper carefully explains his view that the fault lay more in the system than in the individuals. The first flaw in the system was, he felt, the postal monopoly, which exercised an enervating influence upon postal management. He said (Hill 1837, 7):

There cannot be a doubt that if the law did not interpose its prohibition, the transmission of letters would be gladly undertaken by capitalists, and conducted on the ordinary commercial principles, with all that economy, attention to the wants of their customers, and skilful adaptation of means to the desired end, which is usually practiced by those whose interests are involved in their success. But the law constitutes the Post Office a monopoly. Its conductors are, therefore, uninfluenced by the ordinary motives to enterprize and good management; and however injudiciously the institution may be conducted, however inadequate it may be to the growing wants of the nation, the people must submit to the inconvenience; they cannot set up a Post Office for themselves.

Hill also blamed the political and legal circumstances which created a divided system of management. The worst evils were caused by the Legislature, which had no management responsibility. The Postmaster General was the chief executive, but he was a political appointee who at best could only "acquire a general knowledge of the vast and complicated mechanism." And the most knowledgeable executive, the Secretary, "[had] not the requisite authority for effecting such improvements as he may think necessary" (Hill 1837, 40-41).

If one looks at today's international postal system with the same skepticism that Hill brought to the British Post Office of 1840, it is possible that one would likewise conclude that the political and legal system has produced a management structure that is less than optimum. The management of the international postal system consists of about a thousand senior executives (there were some 900 delegates to the last UPU congress) physically located in the international affairs departments of about 170 post offices as well as UPU headquarters in Berne, Switzerland.

Management decisions are taken in meetings of the UPU's various committees as well as meetings of the nine regional postal unions. The central staff, the UPU's International Bureau, has only very limited power to manage the system, or even gather the data needed for management. Even allowing for the large geographic distances and the differences in language and culture—a problem equally faced by the international express companies—this appears to be a rather complicated management structure for a postal system smaller than the Canadian post office.

Like the British Post Office of 1840, the international postal system is also insulated from competition by legal protection: national monopoly laws, favorable customs procedures, antitrust immunity, and so on. In 1987, Mr. Mostafa Gharbi, Assistant Deputy-General of the UPU, wrote an article in the UPU's official magazine which should have earned him renown for courage and wisdom. Mr. Gharbi's theme was "deregulation, a postal modernization factor." He wrote:

A wind of change is currently blowing through postal administrations which, having long been ensconced in the comfort provided by monopoly, have suddenly noticed that they are being seriously threatened by private firms that have started to compete with them...

It is a fact that top postal executives have long tended to give preference to the means provided by regulations in order to solve the management or operational problems facing their administrations. For this purpose, the Post has at its disposal an arsenal of legal texts However, it is being realized ever more clearly that too many regulations can retard progress and restrict initiative and the ability to adapt to new situations.²¹

Rowland Hill would have applauded these insights. And I sense that more and more postal officials, especially younger ones, are beginning to suspect the appropriateness of competition at the international level (leaving the national level to one side). But I may be wrong.

The "winds of change" stirred by the private express industry are beginning to be seen not only in regulatory philosophy, but also in management structure. Twenty of the largest post offices have established a separate international management organization, Unipost. And the UPU itself has, for the first time, authorized its Executive Council to modernize regulations without waiting for the next plenary congress. While I believe there are fundamental legal problems in both cases, in both cases I would also concede that the post offices are rightly searching for a more unified and flexible management structure for the international postal system.

6. Elasticity of the Demand for Postal Services

With an eye towards his governmental audience, a major selling point in Hill's 1837 paper was his proposition that the demand for postal services is elastic. A decrease in postage would result in an increase in revenue. Whether or not Hill was correct in this proposition is unclear to me.²² However, this seems a bit beside the point. Hill was right in that, in some sense, a drastic postage reduction was far less costly in net terms than previously thought and yielded much greater public

benefits. Hill's instinct to price postal services as low as possible appears to have been vindicated.

It is my impression that the international postal system has been unsympathetic to Hill's low price instinct, although a quantitative study would be most interesting. Coddling (1964, 238) recounts numerous debates between high postage and low postage advocates at UPU meetings, with the high postage side almost always victorious (except just before World War I). Most post offices appear to take the view that international postal rates should be set to reap extraordinary profits, since international rates are less politically sensitive than national rates and the mailers are generally well heeled. Like Adam Smith, I have the feeling that it is too much to expect groups of post offices in a collective meeting to reduce rates.

Within the last two or three years, however, the private express companies, acting in concert with individual post offices have become rate cutters for international postage rates. A substantial fraction of all international mail is now being transmitted for 50 percent or less of previous rates. Has this led to a beneficial increase in total international mail volume? Again, I quote excerpts from a 1988 UPU study:

In the period from 1979 to 1986, when the world's population, level of economic activity, tourism, and international trade rose, international mail volumes declined... Postage-rate increases... were widespread.... Most administrations indicated [in answer to a questionnaire] that they face competition. Moreover, the competition is growing.... Most respondents believe the overall market (postal volumes plus privately carried volumes) for LC-type products is increasing.... also... for AO-type products....²³

The obvious implication of these observations is, of course, that competition has led to postage reductions, which in turn have led to the first upturn in international mail traffic for a decade. However, more analytical work is certainly needed in this area.

7. Importance and Practicality of Reform

Finally, Hill was very concerned to persuade his readers that postal reform was both important and politically practical. On the matter of importance, indeed, Hill (1837, 7) was eloquent:

When it is considered how much the religious, moral, and intellectual progress of the people would be accelerated by the unobstructed circulation of letters and of the many cheap and excellent non-political publications of the present day, the Post Office assumes the new and important character of a powerful engine of civilization.

I imagine that the present conference hardly needs to be persuaded of the importance of the exchange of documents. But it may be useful to note that, in the much more complex world of 1990, the corresponding "engine of civilization" is the communications and delivery infrastructure as a whole. When Hill's reforms had reshaped the British Post Office, it was the basic means of exchanging

messages and small parcels between citizens. Today, the citizens of the world require a multiplicity of similar tasks, at various service levels, from a complimentary network of post offices, telecommunications administrations, and private delivery companies (express and non express).

It must be true that, from the public policy standpoint advocated by Hill, what is important today is to ask whether we are making the best use of the international communications and delivery system as whole, in order to ensure that we are not depriving ourselves of the efficiencies and benefits Hill discovered absent from the British Post Office of 1840.

Hill (1837, 54) ends his paper by arguing the political practicality of his ideas, naming names of supporters, and concluding that "the proposed reform, if undertaken by the Government, would not meet with opposition."

I cannot end my paper quite so sanguinely. We have already seen tremendous opposition to reforms in the international delivery system (leaving communications to others), not least from post offices who seem to have forgotten some of Hill's lessons. Nonetheless, fundamental reform does seem practical, for three reasons. First, international traffic comprises only 1 to 8 percent of the postal business, so the most drastic international reforms will not endanger the financial viability of any post office. Second, the European Community's 1992 program has created an opportunity, which otherwise would never arise, to rethink in detail the appropriate public policy towards relations between different postal systems. Third, the United States is in the remarkable position of being the largest supplier of both postal and private delivery systems and Chairman of the Universal Postal Union for the next five years. Logically, at least, the Bush Administration is positioned to play a very positive role. Of course, as in England in 1840, reform, however practical, will in fact occur only if demanded by the users and other leaders of society.

In closing, I would like to repeat that my purpose, in view of the occasion, has been to get an old coat out of Rowland Hill's intellectual closet and try it on today's international postal system. I would encourage others with more specialized skills to straighten it up and apply patches where necessary. Then we can all stand back and judge how well it fits. Perhaps, indeed, it will be seen to fit only to the extent that the international private express industry has, like Rowland Hill 150 years earlier, been successful in persuading the postal system to rethink the nature of its business.

Notes

1. Of course, to be fair, we must assume that Hill Express would have paid the same overall level of tax as the Post Office.

2. In the early nineteenth century, postal rates were viewed more as taxes than as charges for services rendered. According to Hill, postal revenues overall were about three times total costs.

3. The Universal Postal Union is an intergovernmental organization that was formed in 1874 to develop common rules for the exchange of international mail. The major UPU agreement is an international treaty called the "Universal Postal Convention." The UPU, which now includes virtually all governments in the world, convenes a "congress" every five years to revise and readopt the Convention and other agreements.

4. Although remail could transfer volume for one post office's international account to another post office's domestic account (so called "ABB remail").

5. By this, I mean only that, as with many types of economic activity, most postal transactions are concentrated in a relatively few number of markets. The pricing policies suitable for a few reasonably homogenous high density markets do not necessarily apply to many diverse low density markets.

6. More precisely, 76 percent for LC mail and 82 percent for AO mail according to 1979 Congress of the Universal Postal Union, Document 7, Annex 1, Attachment 14, Table 4.7. "Developed countries" in this study referred to 24 free-market industrialized countries. Although out of date, this well done study of the terminal dues problem by the Canadian Post Office remains very informative. No more recent study is known for this particular datum, but there is no reason to believe the proportions have changed significantly.

7. For those fortunately innocent of UPU terms, "terminal dues" are the charges that post offices levy each other for the local delivery of foreign mail (local delivery meaning exclusive of long haul transportation, such as air transportation).

8. It should also be noted that although both examples show a new spirit of economic realism on the part of the post offices, in both cases, the actual agreements pose serious issues under the competition laws.

9. This summary involves a little interpolation, as Hill was not very detailed in explaining his ideas for secondary distribution.

10. Hill did not support differences in postal charges to customers for letters circulating between major towns because the average transportation was only one thirty sixth of a penny. This is not at all the same thing as saying that post offices should not charge other post offices for substantial, clearly identifiable transport costs for bulk mail. Hill's support for proper costing of postal services would presumably have led him to support cost related transit charges between post offices. The question of whether these transit charges were significant enough compared to total costs to justify differences in the ultimate postage rates to mailers is a quite different question.

11. UPU Convention (1984), arts. 63, 83.

12. UPU Terminal Dues Roundtable, 6-7 April 1989, Annex 3: CE 1988/C4 - Doc 9/Annex 1 (emphasis added) (hereafter this roundtable is referred to as UPU TD Roundtable). The several annexes to this work paper provide a detailed analysis of the phenomenon of remail competition among post offices and the postal responses to it.

13. UPU 1989 Washington Congress, C6 - Rep 3, p. 2 (1 December 1989).

14. UPU 1989 Washington Congress, Doc 63.

15. It makes no difference whether one considers this a charge levied against all international mail or only against the "imbalance" arising out of bilateral exchanges.

16. UPU TD Roundtable, Annex 4: CE 1988/C 5 - Doc 8, p. 7. Even within the European Community, postal delivery costs appear to vary by a factor of three or more, judging from variations in both postal cost data and first class LC postal rates.

17. This simplifies the matter somewhat. The 1989 UPU terminal dues provision is very complicated. It contains a correction mechanism for kilograms that contain more than 55 LC items per kilogram or more than 7 AO items per kilogram, although it is unclear to me how this will be administered. It also retains the flat rate per kilogram for bilateral postal markets in which the traffic is less than 150 tonnes per year in either direction. Furthermore, the 1989 convention allows post offices to agree upon alternative terminal dues agreements on a bilateral basis.

18. UPU TD Roundtable, Annex 2: CE 1988/C 5 - Doc 9, p. 12.

19. The domestic postal rates of a low cost post office are, plainly, far below the actual costs of delivery incurred by a high cost foreign post office. In addition, of course, domestic rates do not include international transportation costs, as international postage rates should.

20. If, in accordance with new arrangements, terminal dues vary both by number of pieces and total weight, then both private express companies and post offices will have to introduce tariffs based upon the number of pieces as well as weight. However, the procedures will still be simpler for the mailer than traditionally required by the international post.

21. Union Postale (1987) p. 11A.

22. According to Hill, the overall tax on the postal system was about 200 percent of costs. Some fifteen years after Hill's reforms were introduced, postal revenues had more or less returned to previous levels, but one has to allow for changes in the tax rate and inflation in order to assess whether, even over

this period, Hill's postage reduction paid for itself.

23. UPU Terminal Dues CE 1988/C 5 - Doc 9, p. 3.

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COMMENTS: *International Postal Reform*

Roger Tabor

This paper is a stimulating contribution to an area of postal activity which is not often discussed. It is certainly the case that postal administrations throughout the world could work more effectively together. It is equally true that many of the competitive anomalies that have arisen in the postal world, which for so long has been the object of exclusive privilege within the boundaries of each country, take place in the international arena, where they have been stimulated by unsatisfactory arrangements for a country of posting to compensate the country of delivery of an item of mail.

As a postal operator myself, I would gladly acknowledge the part competition has played in inviting reconsideration of previously immutable positions. Even "re-mailing"—the activity of private operators in helping mailers to enter the world's postal system at the most effective point—albeit anathema to postal people, has done us a service in highlighting the economic nonsense of the terminal dues system.

The United Kingdom has indeed been a prime mover in seeking to reform the settlement arrangements between administrations known as terminal dues. The most recent change at the Universal Postal Union (UPU) in 1989, which the United Kingdom advocated, was able to overcome the apparent stigma associated with dividing countries into developed and less developed, by including a differential arrangement based on the volume of the mail flow.

It may be instructive at this point to consider some illustrative figures. Table 1 compares, in very round terms, what the British Post Office might have expected to receive on various different bases of terminal dues currently available. The likely delivery costs for incoming foreign mail with which the figures should be

Table 1. Terminal Dues (TDs)		
Example: 20g letter for United Kingdom delivery		
		Pence
Posted in U.K.	(Price)	15/20
Receivable under TDs:		
Old UPU	(weight only)	4
CEPT	(weight + per item)	12
Nordic	(60% domestic tariff)	9/12 ^a
New UPU ^b	(weight by stream)	13
^a rises with inland tariff		
^b large flows		

compared will be broadly in the 10p to 13p range, depending on the approach to costing used. The table uses values for a 20 gram letter, as a significant proportion of incoming mail posted abroad into the United Kingdom is at the lightweight end of the market.

It is evident from this that the old UPU formula produced a very low price for delivery in Britain of bulk letters which have been posted in another country. Since the costs to a despatching administration of collecting an item, sorting it to the country concerned, and despatching it abroad are only a small part of the cost of sending a letter, one could surmise that the total cost to an administration, say, elsewhere in Europe, of an item of bulk mail to the United Kingdom could be as little as 8p. This would permit the foreign country to undercut the British Post Office's price for delivery within the United Kingdom even with discounts for bulk.

Competition is, of course, not only about price, and the whole service offering has to be correct. International private operators are also able to take advantage of any differential quality of service as between domestically posted bulk mail, often in a deliberately "deferred" service, and incoming foreign items. But it is inescapable that private operators have been able to assist postal customers to exploit anomalies in international charging, and that the price differential will have been influential in that. The new UPU terminal dues arrangements are due to be brought in in 1991, and we must now wait and see whether they have the significant impact on this situation which, *prima facie*, they appear to do from these figures.

But the main theme of Jim Campbell's paper is to suggest that Rowland Hill's economic principles could be, but have not been, applied to international mail.

His paper does, at one point, seek to distinguish between "truth" and "political reality." Those of us who work in public sector organisations may recognise two distinct forms of reality by these words, but reality they both are. While economic theory can guide the policy maker, it must frequently be tempered by political judgement, and the relative attractiveness of an economic proposition is conditioned by the probability of securing its acceptance and implementation by those in power.

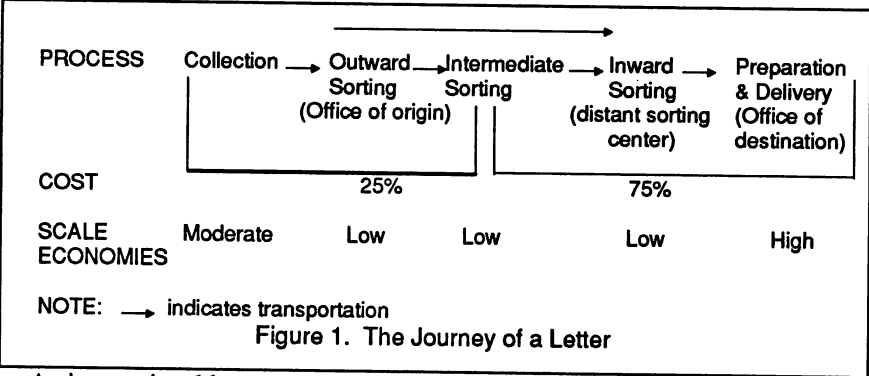
In a way, the problem here may arise from a "big country" perspective. It may seem strange, to one accustomed to the scale of domestic letter operations in the United States, that mail from Athens to London has to be treated with an entirely different frame of reference to that applying between Dallas, Texas, and New York.

Fernando Toledano of the European Commission described the situation in Europe. Here we have a collection of comparatively small—some tiny—nation states. All have their own post offices with autonomy within the country, and there are at least two schools of thought among them about whether the guiding principles for the mail should be primarily economic/competitive or primarily a matter of public service.

Even in the relatively liberal United Kingdom, state ownership of the Royal Mail is not currently an issue. Corporatisation is widespread (often wrongly described as privatisation, which implies a change of ownership), but there is little immediate prospect of organisational change so radical as to permit a European Post Office,

never mind one for the whole world! This existence of national boundaries must accordingly influence our response. We must therefore consider how the act of its crossing a border can influence our judgement about the economies of a letter.

Let us consider what actually happens to a piece of mail. Typically it is collected from the firm or street collection box, and it is taken to a sorting office (sorting center) where it is sorted for despatch to a distant destination. It is then conveyed possibly to an intermediate office where it will be sorted again or perhaps directly to the sorting office which serves the delivery region of its destination. At that distant sorting office, it will be sorted to the local delivery center, where it will then go through the final process of being prepared for the postman to take it out and deliver it. Mail circulation follows these general principles in most countries, although, of course, my model is based on personal knowledge of the United Kingdom. We can simplify this in terms of figure 1.

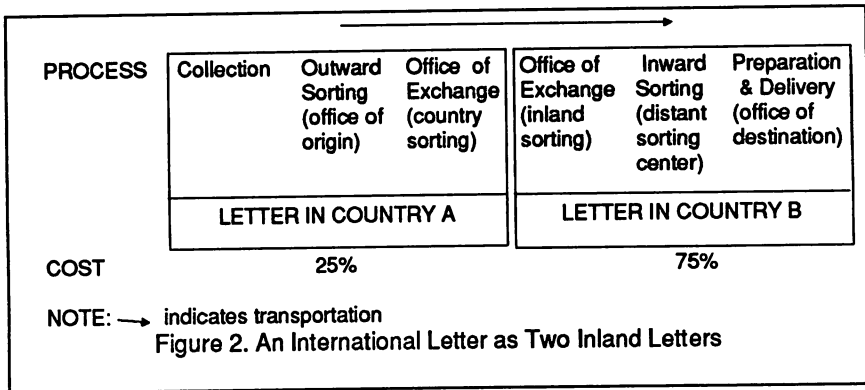


An international letter goes through substantially the same processes, although it typically passes through two intermediate offices which are specially designated for the exchange of international mail, one (outward) in the country of posting and the other (inward) in the country of delivery.

This enables us to look at an international letter as if it were two truncated inland ones. Figure 2 keeps each within the bounds of national sovereignty, while remaining true to Rowland Hill's view that handling of a letter in a foreign country should be "subject to the arrangements there established."

These figures include very rough proportions of the operational staff costs of handling a letter and a note about the relative contribution that each of the processing activities makes intuitively to economies of scale. (The intuition is supported by unpublished studies within the British Post Office. This analysis suggests that the "inward" part of a letter's journey, within the country of destination, is both more costly and more likely to benefit from economies of scale than the "outward" part in the country of posting.)

This would be important from a regulatory policy viewpoint, since if there is a case at all for a monopoly or other protected market position, it seems to rest in the avoidance of wasteful competition, through the exploitation of economies of scale and scope which might exist if there were only one network provider. This case is



strongest at the delivery end. Any delivery manager realises that the economics of his operation rely on the routes being filled to capacity so that the number of drops per call is maximised and idle route mileage is reduced.

In satisfying the condition of deliveries being as "full" as possible, incoming international mail is of equal importance to inland. Take it away, and the unit cost of delivering the remaining (inland) mail would rise. If therefore one accepts the principle that the economics of delivery, the maintenance of a universal service, and the provision of service at an economic price, do require a degree of market protection for the postal service, then it would apply no less to an incoming foreign item. Such a letter has very similar cost characteristics to an inland letter posted in the immediate locality of the inward international office in the destination country.

On the outward side, an international letter has the characteristics of an inland letter addressed to someone residing at the outward international office of exchange. But we see from the exhibits that it avoids the activities which both generate most returns to scale and cost the most in absolute terms. The case for competition here would therefore seem more compelling. Competition is already effectively established at the level of the outward international letter in the remail context. I agree with Jim Campbell that this competition is stimulating a response from some Post Offices. In the United Kingdom, it has already prompted critical reviews of our service quality, our operating costs, and our product portfolio. And on the outward side, our efficiency gains would seem, on the basis of this analysis, to be less threatened by structural loss of economies of scale. The competitive playing field will, however, be more level when the terminal dues payments we receive for delivering mail from other countries more closely compensates us for our costs.

But if a case for regulated non-market services exists at all for letters—and a lot of evidence, and a lot of history says that it does—it *also* applies to *delivery* of international mail. Indeed, it is hard to conceive that a domestic monopoly could be enforceable if delivery of international mail in the same country were allowed: it would be hard to stop a private firm delivering letters in the street and judge from the outside of the envelope where the letter had originated, particularly if they chose to make it so.