

**REVIEW OF THE *AUSTRALIAN POSTAL
CORPORATION ACT***

VOLUME ONE
FEBRUARY 1998

National Competition Council

Commonwealth of Australia 1998

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National Competition Council

19 February 1998

The Honourable Peter Costello
Treasurer
Parliament House
CANBERRA ACT 2600

Dear Treasurer

In accordance with the terms of reference sent to us on 19 May 1997, I have pleasure in presenting to you the Council's report on the competitive restrictions in the *Australian Postal Corporation Act 1989*.

Yours sincerely,

Graeme Samuel
President

Elizabeth Nosworthy
Councillor

Michael Easson
Councillor

Stuart Hohnen
Councillor

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Abbreviations

AaE	-	Australian air Express Pty Ltd
ABS	-	Australian Bureau of Statistics
ACA	-	Australian Communications Authority
ACCC	-	Australian Competition and Consumer Commission
ACCI	-	Australian Chamber of Commerce and Industry
ACTU	-	Australian Council of Trade Unions
ALGA	-	Australian Local Government Association
ASX	-	Australian Stock Exchange
ATSIC	-	Aboriginal and Torres Strait Islanders' Commission
BIE	-	Bureau of Industry Economics
CDEP	-	Community Development and Education Program
CEPU	-	The Communications, Electrical, Plumbing Union
CPA	-	Community Postal Agencies
CPSU	-	Community and Public Sector Union
CSO	-	Community Service Obligations
CWA	-	Country Women's Association
DIST	-	Department of Industry, Science and Tourism
DOCA	-	Department of Communications and the Arts
DRCS	-	Digital Radio Concentrator Systems
DX	-	AUSDOC's Australian Document Exchange Pty Ltd
EBIT	-	Earnings Before Interest and Taxes
EDI	-	Electronic Data Interchange
EFT	-	Electronic Funds Transfer
EFTPOS	-	Electronic Funds Transfer Point of Sale
ELADS	-	Electronic Lodgement and Delivery System
EPOS	-	Electronic Point of Sale
EU	-	European Union
GBEGA	-	Government Business Enterprises Governance Arrangements
GBE	-	Government Business Enterprise

Abbreviations

IC	-	Industry Commission
ICPA	-	Isolated Children's Parents' Association
IDP	-	International Data Post
LPO	-	Licensed Post Office
LPOAL	-	Licensed Post Officers of Australia Ltd
MMUA	-	Major Mail Users of Australia
NCC	-	National Competition Council
NERA	-	National Economic Research Associates
NFF	-	National Farmers' Federation
OCR	-	Optical Character Readers
PC	-	Personal Computer
POA	-	Post Office Agent
POAAL	-	The Post Office Agents Association Limited
PMG	-	Postmaster General
QCIS	-	Queensland Commercial Independent Stationers
RDFG	-	Rural Delivery Frequency Guide
RPM	-	Resale Price Maintenance
SCNPMGTE	-	Steering Committee on National Performance Monitoring of Government Trading Enterprises
TAF	-	Telecommunications Access Forum
TPA	-	Trade Practices Act 1974
UBR	-	Urban Base Rate
UPU	-	Universal Postal Union
USO	-	Universal Service Obligation

Terms of Reference

I, PETER HOWARD COSTELLO, hereby:

1. In accordance with the Commonwealth Government's Legislation Review Schedule, refer to the National Competition Council the *Australian Postal Corporation Act 1989* (and associated regulatory and institutional arrangements) for inquiry and report within nine months of the date of receipt of this reference.
2. Request that the Council advise on practical courses of action to improve competition, efficiency and consumer welfare in the postal services sector. In so doing, the Council should have regard to the objective that the legislation/regulation should be retained only if the benefits to the community as a whole outweigh the costs; and if the objectives of the legislation/regulation cannot be achieved more efficiently through other means, including non-legislative approaches.
3. Request that the Council, in so doing, have regard to:
 - (a) the Government's commitments to maintain Australia Post in full public ownership and provide a standard letter service to all Australians at a uniform price;
 - (b) the Government's commitment to accelerate and strengthen the micro-economic reform process, including through improving the competitiveness of markets, particularly those which provide infrastructure services, in order to improve Australia's economic performance and living standards;
 - (c) the Government's obligations under the Competition Principles Agreement executed in April 1995 which embodies commitments in relation to competitive neutrality, structural reform of public monopolies, access to services provided by means of significant infrastructure facilities, price oversight and legislation review;
 - (d) the current obligations on Australia Post specified in s26, s27 and s28 of the *Australian Postal Corporation Act 1989* to: perform its functions in a manner consistent with sound commercial practice; provide a letter service at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles; and meet any performance standards set for it;
 - (e) Australia Post's current and prospective level of financial and service performance and the flow of benefits to the community from that performance improvement;

- (f) the findings and the reforms arising from the 1992 report by the Industry Commission on mail, courier and parcel services; and
 - (g) experience with postal regulatory reforms undertaken overseas.
4. Without limiting the scope of the reference, request that the Council examine:
- (a) the need for a statutory reservation to Australia Post of the exclusive right to carry letters and the implications of a reduction or removal of the reservation;
 - (b) the specification, scope and extent of:
 - (i) the current letter service reservation and whether it is consistent with the Government's commitment to provision of a universal letter service;
 - (ii) the current community service obligations provided under s27 of the *Australian Postal Corporation Act 1989* and whether current arrangements satisfactorily meet the Government's commitment to community access to services;
 - (c) the scope, extent and organisational structure of commercial activities undertaken by Australia Post other than the reserved letter service. The competitive neutrality issues that may arise including the associated benefits and costs from these activities, should be identified and addressed as necessary.
 - (d) the operation of the current letter mail interconnection arrangements and the possible application of the general interconnection arrangements under the *Trade Practices Act 1974*; and
 - (e) the consequences for small business and other users of further reform of the *Australian Postal Corporation Act 1989*.
5. Request the Council in undertaking the review advertise nationally, consult with key interest groups and affected parties, and release an interim and a final report. The Government will respond to the final report produced by the Council.

Executive Summary

Australia Post needs to keep improving

Australia Post is a dynamic and evolving organisation. It needs to be - its market is shifting dramatically. Household-to-household letters remain an important service, but more than four out of five letters now originate from business. Long gone are the days when household mail was Australia Post's bread and butter, due largely to the widespread use of electronic communications services, such as the telephone. Increasingly, Australia Post must develop its services to incorporate, complement and compete with new communications technologies to survive and prosper.

Australia Post's key assets are its established network, management and skilled labour force. To date, Australia Post has utilised these assets skillfully within the constraints imposed by a restrictive regulatory and governance environment. At the same time, this environment has shackled the growth of competing service providers. The challenge for this review has been to devise a package of new arrangements for the postal services industry which will:

- guarantee the maintenance, and where appropriate enhancement, of social obligations on Australia Post to provide a mail service reasonably accessible to all Australians;
- maximise the contribution of Australia Post to the Australian community; and
- facilitate the emergence and growth of competing firms in the postal services industry in the interests of the Australian community.

The Current Market for Postal Services

Current regulation constrains growth

The postal services industry needs to be viewed as part of the broader communications market. Electronic and physical communications services are converging, and increasingly competing with each other. Electronic communications services are more varied, flexible and, individually, offer significant advantages. Deregulation of telecommunications services is reinforcing these advantages - in

particular, increased competition has meant better products at lower prices. The use of electronic communications services has increased markedly, putting postal services under pressure.

In postal services, Australia Post has a statutory monopoly over some services and competes vigorously in others. Only Australia Post can carry letters under 250 grams for less than \$1.80. In return, Australia Post provides a universal letter service to all Australians at a uniform price (currently, 45 cents). The level of protection for letter services was reduced from ten times to four times the uniform rate in 1994. Australia Post became a corporatised government business enterprise in 1989.

Notably, Australia Post has met the challenge of communications service convergence primarily by diversifying and improving its products in competitive markets. In particular, it has developed hybrid electronic/postal services and improved the range and quality of its parcels services.

But while Australia Post has performed well (particularly since partial deregulation in 1994 and corporatisation), current arrangements for letter services appear to constrain it and other postal service providers from fully meeting the challenge of increasing competition from electronic communications services.

The Reform Package

Business and household letter services should be treated separately

The Council's review revealed a widely-held belief that it is in the public interest to maintain a universal letter service at a uniform price. However, the practical application of this principle has become increasingly clouded with successive amendments to the definition of a letter, the exemptions from the services reserved to Australia Post, arrangements for bulk discounts, and provision for interconnection with the network. By and large, all letters from individuals and households are charged the uniform rate, while many letters forwarded by businesses receive discounts against the uniform rate. Currently, many of the discounts are small, in large part because the uniform rate is used as a starting point and there is little competition to drive prices down.

The Council considers that it is timely to clarify the scope and funding of the universal service obligation while at the same time ensuring that discounted prices are set at a more appropriate level. The key to the Council's reform package is to distinguish between letters originating from households and letters sent by businesses. The Council proposes that arrangements for household letters remain much the same as at present while business letter services should be open to competition. Other components of the recommended reform package then flow from this foundation.

The reform package in summary

The essential elements of the Council's package for the reform of postal services in Australia are:

- to retain the obligation on Australia Post to provide an Australia-wide letter service, with unprofitable parts of the Universal Service Obligation subjected to community service obligation (CSO) funding from a mix of sources;
- that household letter services remain reserved to Australia Post, with a mandated uniform rate of postage;
- open competition in business letter services, with Australia Post free to discount against a maximum charge set at the same level as the uniform rate for household letters;
- open competition in all international mail services;
- the application of general pro-competitive regulation plus limited special arrangements to restrict monopolistic behaviour by Australia Post in the transition to fully competitive business letter services and to ensure access on reasonable terms to Australia Post's CSO-funded services and post office boxes;
- licensing of all letter service providers to maintain minimum standards and ensure that Australia Post's competitors don't free-ride on its obligation to provide comprehensive services;

- accounting separation for Australia Post’s retail operations, reserved services and CSO-funded services; and
- an effective competitive neutrality complaints mechanism for Commonwealth Government businesses.

The Universal Service Obligation

The USO should be retained

The Council recommends the retention of a universal service for both household and business letter services.

USO Standards Guarantee

with quality guarantees and

Currently, Australia Post largely determines the minimum standards for the USO. This causes a conflict of interest between Australia Post’s obligation to behave commercially and its obligation to provide a universal service reasonably accessible to all Australians. The Council recommends that service standards for the USO be established in the *Australian Postal Corporation Act 1989*, to be monitored and enforced by the Australian Communications Authority (aca), and that a service charter should be used to explain these minimum standards to consumers.

CSO Funding

adequate funding

The Council recommends that community service obligations continue to be funded by cross-subsidies between low cost and high cost household letter services, with supplementary funding from the Commonwealth budget. To address concerns about threats to the universal service posed by possible future reviews of Commonwealth funding, to maintain incentives on Australia Post to minimise costs, and to minimise barriers to entry in postal services, the Council recommends that prior to the introduction of the reform package:

- an auditor should independently review the level of budget contribution to the direct costs of providing the community service obligations; and

- funding should be negotiated with Australia Post upfront to cover CSO services for five years.

Funding of the CSO services would be reviewed at the end of the five year period. The Council considers that the level of budget funding of the CSO services would be lower than previous estimates because:

- cross-subsidy funding of the CSOs from low-cost household mail would be considerable;
- the profitability of all Australia Post's retail services has improved markedly over the past few years (previously losses incurred by these retail services contributed to the costs of CSO services);
- previous estimates of the CSO may have been over-generous. For example, the rate-of-return applied to CSO-related capital is currently 18.75 percent. Adjusting this to a more appropriate commercial return of about 8 to 9 percent would decrease the overall CSO costs by around \$10 million per annum;
- the CSO comprises about four percent of Australia Post's revenue from letter delivery. Under these circumstances, Australia Post should only be entitled to 'top-up' funding for CSO services calculated on a long-run avoidable cost basis; and
- the level of 'top-up' funding should recognise that it would be in Australia Post's commercial interests to provide some loss-making services in the absence of a universal service obligation in order to maximise the value of the network overall.

Should the Government choose not to finance CSO 'top-up' funding from the budget, an alternative approach is to impose a levy on letter service providers, including Australia Post, calculated on the basis of each provider's share of the letter market and designed so as to minimise barriers to entry. These levies would form a pool from which CSO 'top-up' funding to Australia Post would be paid. The

Council recommends that the Australian Communications Authority be responsible for managing the funding of the CSO under such an industry levy.

Household Letter Services

Household letter services should remain the same

The Council recommends that the uniform postage rate for household letter services continue to apply Australia-wide, and that household letter services remain reserved to Australia Post. The level of protection of the reserved services should be reduced from four times to two times the uniform rate. This will ensure that, for individuals and households, the provision of letter services will remain the same as current arrangements.

Business Letter Services

but business letter services

The Council recommends open competition in letter services provided to *business*, that is, any entity whose primary function is to provide goods and services, including organisations such as charities and government. Australia Post should be free to compete in this part of the letter services market by, among other things, offering discounts below the uniform postage rate.

and international mail should be open to competition

International Letter Services

The Council recommends that inbound international letter services should be deregulated to open all international postal services to competition.

Pro-competitive Regulation

General pro-competitive regulation has a role

Australia Post is already subject to the general anti-competitive provisions of Part IV of the *Trade Practices Act* (TPA). In addition, Australia Post's reserved services are and should continue to be subject to prices oversight by the Australian Competition and Consumer Commission. However, the Council believes there is value in strengthening pro-competitive regulation in the early stages of deregulation.

As such the Council recommends that:

- Australia Post’s business letter services be subject to prices monitoring by the ACCC under the *Prices Surveillance Act*; and
- Australia Post’s current exemption from the national access regime in Part IIIA of the TPA be repealed.

with special provisions to:

In addition, the Council recommends some limited special provisions:

- to restrict monopolistic behaviour by Australia Post (or any service provider with a substantial degree of market power) in the transition to fully competitive business letter services; and
- to ensure access on reasonable terms to Australia Post’s CSO-funded services and post office boxes.

Monopolistic Behaviour

better regulate predation in letter services, and

The Council proposes a new transitional provision in the TPA to enhance the prohibition on predatory conduct (in section 46) in relation to postal services. The new provision would say that:

- where a postal service provider has a substantial degree of power in a postal services market; and
- the effect of that postal service provider taking advantage of that power substantially reduces competition in that or any other market;

then that postal service provider is presumed to have engaged in conduct for an anti-competitive purpose unless and until it can provide evidence to the contrary.

facilitate access to CSO-funded services and PO boxes

Access

The Council recommends that Australia Post be required to submit an access undertaking to the ACCC in relation to CSO-funded services and post office boxes. This will ensure access to these parts of the postal network priced on a long-run avoidable cost basis

capped at the uniform postage rate. If Australia Post's undertaking has not been approved within six months of deregulation, the ACCC should impose appropriate arrangements.

Licensing of Letter Service Providers

The Council recommends that all letter service providers be licensed and subject to an industry code to ensure minimum standards in letter service delivery (such as return-to-sender and mail redirection) and that there is no free-riding on Australia Post's obligation to provide a comprehensive range of services. The ACA will help develop, monitor and enforce the licence conditions of service providers. It will have the power to impose standards if service providers do not reach agreement on an industry code.

Structural Reform

Accounting separation for some services

The Council considered and rejected the structural separation of parts of Australia Post's business. Structural separation would undermine Australia Post's ability to take advantage of economies of scope in mail services.

Nonetheless, the Council recommends the accounting separation of Australia Post's reserved, CSO-funded and retail services to:

- ensure the availability of sufficient data to enable accurate estimation of the costs of CSO services; and
- provide the information needed to investigate complaints about abuse of market power and lack of competitive neutrality.

plus a competitive neutrality complaints mechanism

Competitive Neutrality

The Council has made some recommendations on specific competitive neutrality issues. In general, however, it considers that the package of measures outlined above will deal with concerns expressed to

this review of a lack of competitive neutrality in some parts of Australia Post's business.

Future competitive neutrality issues should be handled by the Commonwealth's competitive neutrality complaints mechanism, which is expected to be fully operational by July 1998.

Impact on Australia Post

Australia Post will remain profitable

Australia Post proposed a package of reforms to this review that involved:

- phased reduction of the reserved services protection to one times the uniform postage rate;
- a halving of the weight limit to 125 grams by 2001; and
- a review of arrangements in 2003.

The package also included the retention of existing access arrangements, new discounts on barcoded mail, retention of the 45 cent uniform letter rate until 2002 and a charter of postal responsibilities. Australia Post argued that this package constituted the outer limit of reform possible without compromising the viability of its business and/or the standards of the universal letter service.

The Council considers that Australia Post has underestimated the level of reform its business can tolerate as it underestimated the effect of 1994 changes. In 1993, Australia Post estimated that the 1994 changes would put at risk \$250 million of revenue. The actual loss of growth was only seven percent of this original estimate. Australia Post has demonstrated its ability to flourish in competitive markets. Already two thirds of its profit is generated from services open to full competition.

While the reform package proposed by the Council looks very different to Australia Post's package, in gross terms both packages lead to significant increases in revenue earned in competitive markets. The 1994 amendments deregulated some letter services which, at the time, accounted for around ten per cent of Australia Post's annual

revenues. Currently, about fifty percent of Australia Post's revenue is earned from services in competitive markets. Under Australia Post's proposal, this would increase to 84 percent. This compares with the Council's package where the revenue exposed to competition is 93 percent, albeit phased in over a shorter time-frame. The main difference lies in the deliberate targeting by the Council of deregulation of services where competition would provide the greatest benefits to the community and the least threat to the universal service obligation.

Since the 1994 reforms, Australia Post has been a very profitable business; in fact, more profitable than similar businesses operating in a competitive environment. Australia Post operates a relatively low risk network business. Yet its return on assets is high compared to all publicly listed companies, is higher than any public company in the transport industry and equals the best performing public company in the retail sector. Consultant work to this review by Arthur Andersen suggests that even under a 'worst case' scenario for Australia Post, the Corporation would earn at or around a commercial rate of return on assets for its type of business until at least 2005. This 'worst case' scenario assumes full deregulation of letter services, no increase in prices, retention of the USO without compensation, no growth in the market as a result of increased competition, no additional cost-cutting, productivity or marketing measures and the retention of existing capital expenditure plans.

The funding methods for CSO costs as recommended by this review would ensure the continuation of Australia Post's viability and its universal service obligation.

*while
growth and
new
entrants in
the mail
services
industry*

Impact on the Postal Services Industry

The industry is likely to develop two distinct types of service provider. The first type will compete head-to-head with Australia Post, offering a full network service, albeit with different products and over geographic areas ranging from local to near-nationwide networks. The second type will provide some processing services but utilise the network services of others. Both deregulation and the access

arrangements recommended by this report will eliminate the current competition bottlenecks in postal services. Further, the contesting of components of the service chain by new service providers will be an important source of competition in the industry.

Australia Post is likely to remain in a strong position in the market - it is capable of competing strongly and is unlikely to sacrifice market share easily. But regardless of the market penetration of other service providers, the level, quality and prices of postal services will be more responsive to customer needs. Price competition in high-use segments of the market is likely to be fierce, while the take-up of new technology and product diversification is likely to increase across the board.

Impact on Consumers

will enhance services and reduce prices

Australia Post argues that 45 cents offers good value for its letter service and that reducing this rate would have little impact on consumers. This is true for individual and household consumers, but not for services to business. The use of postal services for the marketing and delivery of, and payment for, consumer products is growing rapidly. Competition in business letter services will provide a significant fillip to this activity, by increasing the range and quality of services, reducing prices and increasing the responsiveness of business to the needs of customers.

Impact on the Australian Economy

leading to higher growth and productivity

Postal services are used by every business in Australia. There are only a few essential services which affect the costs of so many businesses. Therefore, the cost of postal services is not only important from the perspective of the postal industry, but also its impact on all industries in Australia. Lower prices for this essential service will flow through into lower costs across the whole economy.

Impact on Employment

with higher employment

As in telecommunications, employment in the postal service industry is likely to be closely linked to the level of activity in the market. While deregulation is likely to mean that Australia Post will reduce staff numbers in the short term, this is likely to be more than offset by increased employment flowing from the growth of existing service providers and new entry to the industry. This is supported by historical evidence - since limited deregulation in 1994, Australia Post's workforce has risen slightly while Australian Bureau of Statistics' figures indicate total employment in the industry has increased.

Moreover, a healthy, competitive postal services industry will be better equipped to meet the challenge of competition within the broader communications market, and thus provide more stable, reliable employment.

Summary of Recommendations

Key Recommendations

In order to ensure the appropriate **social objectives** are met, the Council recommends:

- > the retention of the letter delivery USO because the CSO costs incurred are fully justified by the social benefits, and there is no effective alternative means of providing the social benefits;
- > that the uniform rate of postage apply to individuals and households posting standard size letters. Australia Post should be allowed to offer discounts to business customers, but no business should be charged more than the uniform rate for posting a standard size letter. The Government should review the possibility of introducing a maximum affordable charge for household letter services in 2005;
- > funding of the CSO by direct budgetary payments¹; and
- > that the Government negotiate CSO funding in advance for five year periods.

To ensure **increased competition** is achieved, the Council recommends that:

- > business mail should be opened to competition. The minimum competitors can charge for those letters which remain in the monopoly (household mail) should be two times the standard letter rate; and
- > inward international mail be opened to competition.

¹ If budgetary funding is not adopted, the Council believes that the industry levy is the best alternative method for funding CSOs.

Recommendations

In addition to the **key recommendations** set out above, the Council has made a number of **further recommendations** to consolidate the reform package.

Toward achieving additional social objectives, the Council recommends that:

- > the regulations being developed under section 28C cover all aspects of Australia Post's letter delivery USO. The regulations should be developed jointly by the postal regulator and the Department of Communications and the Arts;
- > the role of the service charter should be to make Australia Post's obligations under the regulations clear to the public;
- > a postal regulator should monitor and report to Government on Australia Post's performance against the regulations, and recommend amendment as necessary. Australia Post should publish its performance against these measures annually;
- > the application of the new Rural Delivery Frequency Guide formula should be monitored to assess whether it is equitable in determining the number of deliveries to rural and remote postal users;
- > Australia Post re-poll communities where, if abstentions had been ignored, the vote supporting an extension of delivery would have outnumbered the vote against extension. If a community vote is in favour of street delivery, people should have the option of requesting over-the-counter delivery at no cost to themselves;
- > Australia Post ensure that the level of remuneration paid in respect of postal agency arrangements established in remote communities that receive mail by community bag is comparable to the remuneration that Australia Post would pay to a CPA/LPO and/or a contract deliverer to perform similar services;
- > the annual fees in relation to private bags and locked bags should be abolished for all postal users receiving a delivery service less than three times a week; and
- > the Government should not seek to contract out CSO activities at this stage, but that this policy should be reviewed in 2005.

In relation to the **price of postage stamps**, the Council recommends that:

- > the current rate of postage of 45 cents should remain if the Council's recommendation to deregulate business mail is adopted. Australia Post should be free to lower the rate of postage below the current rate if it wishes; and
- > the exception to the resale price maintenance provisions be reviewed in conjunction with the review of the uniform rate of postage in 2005.

To address **other competition issues**, the Council recommends that:

- > the right of Australia Post to erect posting boxes should be maintained for the ordinary red posting boxes suitable for posting standard letters. Otherwise, Australia Post should be subject to the same requirements as other postal services providers.

To ensure the **postal industry** is adequately **regulated**, the Council recommends that:

- > in a deregulated postal services market, the ACA administer postal services regulation outside the ambit of the ACCC. Specifically, the ACA's charter should be expanded to give it responsibility for administering:
 - the assessment and funding of the postal CSO, if there is an industry levy;
 - monitoring systemic issues associated with Australia Post's compliance with the CSO;
 - enforcing CSO compliance;
 - licensing of Australia Post and other postal service providers;
 - monitoring and enforcing compliance with postal service provider licences; and
 - administering the establishment and enforcement of industry codes of practice covering service standards;
- > if the protocols *critical* to protecting customers and enabling interconnection to function are not in place at the time of market liberalisation, the regulator for postal services should itself determine

- standards applicable to such matters, in consultation with stakeholders. This should occur within six months of market liberalisation;
- > the Commonwealth Ombudsman should continue to deal with individual complaints about Australia Post's non-compliance with the USO; and
 - > Australia Post should continue to be designated as Australia's official postal administration to the UPU. This should be reviewed in 2005 having regard to the ability of private postal service providers to supply a universal service.

In relation to **access regulation**, the Council recommends that:

- > a compulsory undertaking, to be approved by the ACCC, be developed by Australia Post for CSO and post office box services; and if Australia Post does not submit an acceptable undertaking the ACCC should determine the terms and conditions of access;
- > only the direct cost of providing access to CSO and post office box services should be taken into account in determining access prices. These costs would include consideration of Australia Post's return on assets; and
- > Australia Post's exemption from Part IIIA of the *Trade Practices Act* should be repealed.

To address **anti-competitive conduct**, the Council recommends:

- > a new section of the TPA dealing specifically with anti-competitive conduct in the market for postal services. The need for this provision should be reviewed in 2005; and
- > a requirement for detailed auditing and accounting information on Australia Post's activities, to provide for transparency of the financial relationships between different elements of the business.

In relation to **prices oversight**, the Council recommends:

- > that the reserved services be subject to the same method of prices surveillance as currently applies. That is, proposals to change prices or terms and conditions for reserved services should continue to be

notified in advance to the ACCC and the price should continue to be subject to approval by the Minister; and

- > the ACCC should undertake regular prices monitoring of non-reserved services for the first five years of deregulation. The need for this provision should be reviewed in 2005.

To ensure Australia Post's business is **competitively neutral**, the Council recommends that:

- > the mechanism for handling competitive neutrality complaints that arise in relation to businesses owned by the Commonwealth Government be formalised as soon as possible;
- > if there are any taxes, rates and charges remaining to which Australia Post is not currently subject, these should be imposed on Australia Post without delay in accordance the Competition Principles Agreement;
- > the *Customs Act* be amended promptly to ensure that all postal operators are subject to a threshold to the same value;
- > any provisions which grant Australia Post employees and contractors an exclusive right to operate motorcycles on footpaths be amended to ensure other postal deliverers can obtain similar exemptions when required;
- > the following sections of the *Australian Postal Corporation Act* should be removed:
 - section 32 which gives Australia Post the right to impose its own terms and conditions upon which its service can be supplied;
 - section 34 which exempts Australia Post from liability for any loss or damage suffered due to an act or omission by Australia Post;
 - section 46 which gives the Minister the power to influence whether Australia Post undertakes significant business activities;
 - section 90B which prohibits any State or Territory law from discriminating against Australia Post;

- section 90D which restricts the application of State and Territory building and construction laws to Australia Post prior to 1 January 1991;
- > the following be amended as specified:
 - section 48, which requires Australia Post to comply with general policies of the Commonwealth Government if notified to do so by the Minister, be amended to ensure that the Minister must first table the applicable general policies in Parliament;
- > and the following sections be extended to cover all postal operators:
 - section 90V so that all participants are required to place a notification on an article that has been opened for any purpose or reason;
 - Division 2, Part 7B so that all participants are required to comply with general privacy requirements; and
 - section 101 so that all participants are granted title to all postal articles for the purpose of any legal proceeding and that the property rights of customers be clarified.

Overview

About This Review

High quality and reliable communications are vital to a country's economic and social prosperity. This is particularly important to Australia given its large and sparsely populated rural areas and substantial distances between population centres.

Postal services are, and always have been, an important part of communication systems in Australia. Since federation, when an Australia-wide mail service was introduced, the development of Australia's postal authorities has been driven by the need of all Australians for postal services.

In 1901, the Commonwealth Postmaster-General's Department was vested with responsibility for postal (physical) and telephonic (electronic) communications services in Australia. In 1975, the Department was separated into postal and telecommunications entities, creating Australia Post and Telecom (now trading as Telstra). Australia Post was established as a legislated corporation in 1989 under the *Australian Postal Corporation Act* (the Act) and Telstra was similarly established in 1991 under the *Telstra Corporation Act*.

The Act guarantees an Australia-wide postal service, known as the universal service. It requires Australia Post to provide a letter service to all people in Australia at a uniform price, regardless of where they live. Currently, this means that Australia Post's customers pay 45 cents to send a letter anywhere in Australia. In some cases the cost of delivering that letter is less than 45 cents - for example a letter sent to someone living in the same suburb in Sydney. In others, the cost is much more - for instance sending a letter from Halls Creek in Western Australia to Bothwell in Tasmania.

To enable it to provide this universal service, Australia Post has been given an exclusive right to provide some postal services. Basically, any other provider who wants to carry letters weighing less than 250g must charge at least \$1.80.

This enables Australia Post to use the profits generated from the services that cost less than 45 cents to cover the losses incurred where the service costs more than 45 cents.

This review examines whether current arrangements in the postal services industry are appropriate to meet Australia's future needs.

Background to the Review

Since 1974 the *Trade Practices Act*, which is Commonwealth legislation, has prohibited certain anti-competitive conduct; but its application in some areas of the economy was limited. For example, certain provisions of the *Trade Practices Act* did not apply to Australia Post until 1989. The National Competition Policy (Hilmer) Review carried out in 1993 recommended, as part of a National Competition Policy package for Australia, that the *Trade Practices Act* be extended to cover all business activities, including those owned by governments. The purpose of the Hilmer Review was to provide a framework toward improving Australia's international competitiveness and the living standards of Australians.

It was recognised, however, that extending the scope of the *Trade Practices Act* might not be enough to generate effective competition in some markets. Therefore, further measures to address restrictions on competition were included in three intergovernmental agreements adopted by all governments in 1995. These agreements are the *Conduct Code Agreement*, the *Competition Principles Agreement* and the *Agreement to Implement the National Competition Policy and Related Reforms* (jointly called the National Competition Policy Agreements).

One of the measures agreed under the National Competition Policy (NCP) was to review and, where appropriate, reform legislation which restricts competition. Many pieces of legislation in Australia contain provisions that restrict competition. For example, legislation may limit what people can buy and from whom they can buy it. While some of these restrictions perform a necessary function, such as protecting people from dangerous products, it is desirable to review all restrictions periodically to determine whether they remain necessary. Governments have agreed to undertake and complete reviews of legislation and implement any reforms by the end of the year 2000.

The Commonwealth Government had timetabled the Australian Postal Corporation Act 1989 for review in 1997 and obtained the agreement of State and Territory governments that the review be conducted by the National Competition Council. The Commonwealth Treasurer forwarded Terms of Reference for this review to the Council on 19 May 1997.

The Council recognises that the legislation review commitments are not about automatically removing restrictions on competition, but about removing unnecessary

restrictions on people's freedom of choice. Consistent with NCP provisions, during the course of this review the Council has examined:

- the need for the provisions which restrict competition;
- whether the overall benefits to the community of restricting competition outweigh the costs; and
- whether there are other ways to achieve the identified social objectives without restricting competition.

The Council has also examined other matters. Governments agreed under NCP that government businesses should not be treated any differently from their competitors in the private sector - that is, government businesses must be competitively neutral. This requires that government businesses be corporatised, where appropriate, and that they be subject to:

- full Commonwealth, State and Territory taxes or tax equivalent systems;
- debt guarantee fees to offset the competitive advantages provided by government guarantees; and
- regulations applying to the private sector businesses such as those relating to environmental protection, and planning and approval processes.

Governments also agreed to consider establishing independent oversight of the prices charged by their monopoly and near monopoly businesses. Further, when planning to increase competition, it was agreed that structural reform should be considered including:

- the merits of separating out the monopoly components of the business;
- the best way of separating regulation from the commercial functions of the business;
- the community service obligations and how they are funded; and
- the financial relationship between the business and the government.

The NCP package also includes mechanisms, found in Part IIIA of the Trade Practices Act, which set out the conditions under which one business has a right to use infrastructure owned and operated by another business.

The Terms of Reference for this review require the Council to consider the application to Australia Post of all of these components of the National Competition Policy package.

The National Competition Council

The National Competition Council is an independent advisory body for all governments on issues related to implementing the NCP agreements. The four members of the Council have been drawn from different areas of the private sector and from different parts of the country to provide a range of business experience and expertise.

The role of the Council is to support the National Competition Policy reform process. It has a role in the following broad areas:

1. recommendations to governments on access to significant infrastructure services;
2. assessment of State and Territory governments' progress in competition policy reforms;
3. recommendations on whether State and Territory government businesses should be declared for prices surveillance by the Australian Competition and Consumer Commission (ACCC);
4. advice to the Commonwealth when it is considering overriding State or Territory exemptions from the Trade Practices Act; and
5. other work on competition policy as agreed by a majority of the stakeholder governments.

The review of the *Australia Postal Corporation Act* and postal services falls into the fifth area.

Consultation

The Council would like to thank the many individuals and organisations that participated in this review. Without their information, views and feedback, it would have been impossible to develop a practical reform package.

The Council received 138 submissions from people representing community groups (with both rural and urban interests), Australia Post's employees, businesses (including competitors and customers of Australia Post), local councils, owners of licensed post offices, governments and Australia Post itself.

The Council also met with a broad range of groups and individuals. Meetings were held in all capital cities, as well as Port Hedland, Townsville, Mt Isa, Cairns and rural Victoria. When face to face meetings were not possible, issues relevant to the review

were discussed over the telephone. The Council held approximately 130 meetings. As a guide, the following table allocates the meetings held against the broad interests of the people involved. The table does not total to 130 because some groups were interested in more than one area.

Area of Interest	Number
Community and rural interests	47
Small and local business	15
Business generally	28
Research organisations and academics	3
Local government	10
State and Territory government bodies	22
Commonwealth Government	9
Licensed Post Offices	9
Australia Post regional and state offices	9

A complete list of submissions and meetings is at Appendix 1.

In addition, the Council conducted three workshops to facilitate interactive discussion on some areas of particular interest to this review. They discussed:

1. the provision of the Universal Service Obligation (USO) and whether it should be expanded to include parcel services, financial services and the availability of post offices;
2. the definition of a letter and how it affects competition; and
3. what arrangements, if any, should be introduced to govern the terms and conditions under which large customers and competitors can lodge mail into Australia Post's network (access to essential infrastructure services).

Consistent with its Terms of Reference, the Council advertised the start of this review in national and several major state newspapers, and called for written contributions. The Council released an interim report in the form of an Options Paper in September 1997, and allowed a further two months for people interested in the review to respond.

2. The Challenge for Postal Services

Communications services have been, and continue to be, critically important to Australia's development and to overcoming the barriers of distance that confront this country. In 1901, during the second reading speech of the Post and Telegraph Bill, the Member for Parramatta, Mr Joseph Cook, noted that, in contrast to the postal services in Europe:

... our main purpose on this continent is development, and to give as far as possible those communal advantages which arise from the aggregation of the people in large numbers, to those in our back country who cannot enjoy the privileges we have in more settled parts (Hansard 1901).

These views are still common today. The most recent review of Australia Post said:

Rural and remote communities face pressures of isolation and poorer access to a range of goods and services compared to the urban community. The postal service helps to break down this sense of isolation (Vaile Report 1996, p. 35).

Communications services have been, and remain, acutely important to Australia due to its geography and population distribution. Australia's population is small and dispersed. In addition, we are physically isolated from a number of countries which are culturally and economically important to us. Contemporary communications also are critical to Australia's future. This review focuses on building a dynamic and flexible postal services industry that can meet Australia's future communication needs.

Developments in Communications

The communications industry is one of the most diverse and dynamic sectors of the Australian economy. The Australian Bureau of Statistics defines the communications industry as covering postal services, telecommunications, radio and television broadcasting services. The industry is characterised by high levels of investment and growth, increased competition and technological change.

In Australia, market liberalisation in the telecommunications sector over the past eight years has led to a significant number of new entrants and increased competition in equipment and service provision. The reforms have contributed to increased market

growth, investment, employment, service quality and product range, and lower prices. Between 1989 and 1994, the telecommunications industry's share in Gross Domestic Product grew from 2.6 percent to 3.2 percent. This rate of growth was above the OECD average (Budde 1997b, p. 45).

With more affordable information transmission services and equipment such as facsimile machines and personal computers, the penetration of electronic communications into the market place has been significant. Electronic services are offering more reliable and efficient ways of communicating through both verbal means and use of text and graphics. At the same time, technological improvements, economies of scale and competition in electronic communications services are making these services increasingly affordable for both individual and business users. As is frequently the case with new communications technologies, business users have been the early adopters of these new services.

Widespread acceptance of the new electronic services is affecting the demand for postal services. It is estimated that approximately 85 percent of physical mail is sent by business. Therefore, the impact of new electronic communications services on Australia Post's core revenue is potentially significant. Electronic substitutes for postal services include the internet, electronic mail, facsimiles, Electronic Document Interchange (EDI), Electronic Funds Transfer (EFT), telephone, radio, television and interactive television (NERA 1997a).

The potential for electronic services to affect postal services has been recognised overseas. According to NERA¹:

The threat from electronic communications is significant. Competition from new postal operators is not the only threat to the financial viability of incumbent postal authorities. Finland Post has stated that the greatest threat comes from new technology with about one third of all traditional letters having been replaced by data transfers, telefax and electronic mail services. Sweden Post, attributes the significant decline in its profit over the past two years to technological developments as well as postal competition. All other postal operators reviewed in this study have also recognised the threat from electronic communications (NERA 1997a, p. 26).

1 National Economic Research Associates (NERA) is a consultant to this review.

Impact on Growth in Postal Services

Most commentators predict that the total messaging market will grow quickly. Within that market, however, the ability of postal services to increase their volume of business will depend on:

- providing low priced, quality services to minimise customers' incentives to swap to new technologies;
- capitalising on those areas suited to postal services; and
- exploiting new opportunities.

The message market is also changing. Services and mediums for service delivery traditionally associated with post and telecommunications - as well as computing, entertainment and various forms of commerce - are merging to form new integrated services and delivery media. The internet is the most recognisable example of the integration of various electronic services. Australia Post's hybrid postal/telecommunications service, EDIPost, is an example of integration between electronic and physical communications services.

With the growth of amalgamated services, a broader view of communications services and the communications market is needed. Traditional postal services are an important component of this market, but they are only one option in a field where the array of options is expanding. For postal services to continue to grow in the digital era, it will be necessary for industry participants to anticipate the needs of business and innovate to meet those needs.

Australia Post and other postal providers have acknowledged that technological evolution is a source of new business opportunities. They are pursuing these opportunities by providing new and innovative services. By combining the mail system's universal access and delivery capability with the speed, efficiency and reliability of electronic media, many of the new services supplied by Australia Post, and private communications companies, demonstrate the opportunities for value to be added to the existing postal service. Examples include: people being able to review and request information over the internet which is then sent in hard copy form; or businesses transmitting time sensitive documents close to their destination where they can be then printed and delivered. Innovation in postal services has been strongest where the challenge from electronic services has been pronounced. Greater competition in the provision of postal services has the potential to facilitate further innovation and market growth.

Importance of Postal Industry to the Community

Rural and remote customers are gaining greater access to high speed electronic services, but the practical difficulties experienced by some customers remain. Responses to this review indicated that many customers still rely heavily on physical mail deliveries.

Similarly, some other groups in the community, including the aged and lower income earners, may not have access to the technology needed to use electronic messaging services. A study by the Bureau of Transport and Communications Economics in 1996 indicated that only 6 percent of low income households were likely to acquire a computer by February 1998 compared to 40 percent of lower middle income earners, 54 percent of middle and 50 percent of upper middle income earners. Traditional postal services, therefore, will continue to be important to significant segments of the community both within metropolitan centres and in rural and remote areas.

However, it may be unreasonable to depend on the postal industry, in its current form, to both match the advances in telecommunications and meet the needs of all community groups. While Australia Post has actively developed new services, particularly in competitive markets, some concerns remain. It may not be possible for one business to efficiently develop or provide the full range of services to meet all customers needs and still retain sufficient focus on the core business:

- The current arrangements in postal services seek to ensure a level of basic services at a uniform price but they do not focus on the potential to develop new services.
- It is likely that the company best suited to developing or producing each new product will vary in size, skills and expertise. For example, a company able to provide hybrid product distribution services linked to the internet is likely to be very different from one which can develop new billing systems for utilities.
- Restrictions on competition prohibit other companies with experience in other sectors from expanding into postal services to increase the types of services on offer.

So there is an increasing risk that some people will use telecommunications services because postal providers are unable to offer them the new products and services they seek.

It is important, therefore, that the Council present a reform package that maintains community standards and meets business expectations while ensuring postal services can maximise their potential in the increasingly competitive communications environment. Whether current regulatory and institutional arrangements provide the most appropriate framework to drive innovation, efficiency, growth and, ultimately, consumer benefits in the postal services market of the future is a key issue for this review.

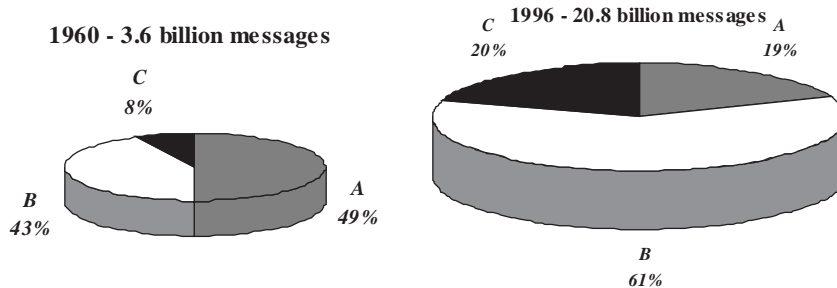
3 The Challenge for Australia Post

The challenges for postal services will particularly impact on Australia Post, affecting the way it competes with other communications services and its relationship with competitors in the postal market. Thus the risks to the postal industry are also risks faced by Australia Post and the challenge to Australia Post is how to adapt to the ongoing evolution of communications technology.

Services Provided by Australia Post

As part of the broader communications market, postal services' market share is clearly diminishing, as can be seen from the pie chart below.

Chart 3.1 Comparison of Messaging Market Share by Volume: 1960 and 1996



- Legend:**
- A Postal Services**
 - B Telecommunications** (Phone, telegrams, telex, fax etc. Excludes electronic funds transfer such as bill payment, EFTPOS and ATM transactions.)
 - C Other** (including courier freight and unaddressed leaflets)

Source: Australia Post, submission 8, p. 23

Still, the actual volume of mail carried in Australia has increased in recent years. Between 1990 and 1996, the total volume of mail in Australia increased at 3.6 percent per year (Sutton & Ofei-Mensah 1996, p.3), and mail volumes are predicted to rise by approximately 4 percent each year into the next century (Australia Post, submission 8, p.23).

Australia Post's business does not depend solely on the letters market. In other services, such as parcel delivery and Express Post, Australia Post already has demonstrated its ability to compete, and maintain a healthy market share. Australia Post also provides postal services, retail services, electronic and communication services, financial services and fulfilment and warehousing services. The range and complexity of these services is increasing.

Australia Post's performance

Since corporatisation in 1989, Australia Post has achieved strong financial performance. As a commercial business Australia Post generates sound profits and high returns on assets and the shareholder's investment.

Australia Post's revenues increased from \$2.3 billion in 1991-92 to \$3.1 billion in 1996-97, an increase of 26 percent over five years. Record profits were made between 1994-95 and 1996-97 being \$331.6 million, \$344.1 million and \$346.6 million respectively.

A large part of Australia Post's improved performance since 1992-93 comes from an end to the losses associated with its retail activities. In 1991-92 Australia Post's retail business lost \$85 million. By 1996-97 this had changed to a small profit of \$18 million. The turnaround of approximately \$100 million per annum appears responsible for a large proportion of the increase in profits since 1991-92. One important strategy by Australia Post toward achieving improvements in its retail activities was to convert a significant number of its post offices to Licensed Post Offices (LPOs are privately owned and operated post offices). A key part of Australia Post's future strategies is to further improve the performance of its retail business to achieve commercial returns.

Cost reduction strategies adopted by Australia Post also have contributed to its improved performance. Australia Post has increased its labour productivity by improving its relationship with its workforce and increasing investment.

The competitive services provided by Australia Post are responsible for most of its overall performance. These services provide some two thirds of the operating profits while using fewer assets than those services where Australia Post has a monopoly.

Australia Post performs well against its corporate objectives and against comparable organisations, including overseas postal services. According to the World Bank:

It is evident that Australia Post has benefited tremendously from its reform efforts. It is now ranked among the world's better performing postal enterprises (Ranganathan, K. and R. Dey 1996, p. 241).

For example, the basic postage rate in Australia, using a purchasing power comparison, is cheaper than Canada, the UK, Germany, and Japan but higher than New Zealand and the United States.

Australia Post has been able to consistently provide large dividend payouts, capital payments, and make significant investments in its network. Between 1991-92 and 1996-97, Australia Post invested nearly \$1.4 billion, and made dividend and capital payments of more than \$1.1 billion, with little reliance on external borrowings. Australia Post has observed that:

Since corporatisation, our performance on all counts - operational and financial - has been outstanding, and we are now widely recognised as providing one of the most reliable and lowest cost mail services in the Western world (Australia Post, Submission 8, p. 9).

Overall, Australia Post's rate of return significantly exceeds that of businesses in sectors comparable to Australia Post. Postal services are a relatively low risk network business. Australia Post sells into a mature and relatively stable market and the investment it needs to meet future growth is relatively small compared to the total size of its business. Given the returns in sectors facing risk comparable to Australia Post, the Council believes an adequate return on Australia Post's assets would be around 8 or 9 percent.

Over the period 1992 to 1995, Australia Post's return on assets ranged between 9 and 16 percent. These returns are much higher than the average for publicly listed companies over the same period. The return on assets across all public companies from 1992 to 1995 was between 6.3 and 8.3 percent. Australia Post's returns were

higher than the best performing company in the transport sector and equal to the top performer in retailing.

Over the same period, Australia Post's return on equity ranged between 13.3 and 27.7 percent. This was about three times higher than the highest average for publicly listed companies and it performed better than the best company in both the transport and banking sectors and only slightly below the best company in the retail sector.

Key questions arising here are:

- Should the benefits of a strong postal industry be captured solely by one organisation?
- Should Australia Post's past performance exempt it from further reform?
- Is Australia Post likely to perform as profitably in the future as it has done since corporatisation?

The above discussion suggests that Australia Post's performance has remained strong despite amendments to the Corporation's competitive environment in 1994. In fact it is likely that the 1994 amendments encouraged Australia Post to continue its move to increased productivity and efficiency. The Corporation, therefore, is well positioned to progress to the next stage.

1994 amendments to the Act

The 1994 amendments to the *Australian Postal Corporation Act 1989* allowed competition in a number of services previously reserved to Australia Post. In summary, these products fall into six categories:

- domestic letters weighing between 250 and 500 grams;
- domestic letters carried for between \$1.80 and \$4.50, including
- products linked to domestic letter prices, such as bulk discounts;
- newspapers, magazines, books, catalogues and leaflets directed to a particular person or address and enclosed in a cover;
- letters moved within document exchange networks;
- Express Post (DL, C5 and B4 sizes); and
- international outward bound mail.

Australia Post has demonstrated its capacity to change and to meet the challenges from competition. It also has shown its ability to innovate and that it is well situated to adapt to and benefit from future change.

4. Benefits of Competition

Competition can bring significant community benefits. It can encourage businesses to offer people ‘more for less’ by improving quality and reducing waste. It can encourage businesses to adapt quickly to new technologies and changes in what consumers want and to focus on those services the business is best at providing.

At a broader level, competition helps ensure that the community’s scarce resources - including people’s skills and ideas - are used in the most valuable way, now and in the future. In addition, firms which are more efficient have greater capacities to adjust to changes in economic conditions.

The Council believes that expanding competition in the postal industry will benefit business, including medium and small businesses and, in turn, consumers. Increased competition will lead to four significant benefits for Australians.

1. Increased efficiency and lower costs

A business with a protected monopoly tends not to take full advantage of cost savings which means consumers pay higher prices than necessary. There is also no incentive for a business with a protected monopoly to pass cost savings on to consumers. A number of submissions argued that Australia Post tended to proceed slowly in implementing efficiency improvements. According to Streetfile:

... there has been no benchmark for the quality and price of the service provided by Australia Post. Australia Post has been afforded the luxury of improving efficiency at its own pace and at the expense of the consumer. (Streetfile, submission 10, p. 31)

And TNT claimed that:

... in the uncontestable areas of its monopoly, Australia Post has no incentive to innovate, improve its cost

effectiveness or price more efficiently. (TNT, submission 43, p. 2)

2. **Lower prices**

The price of posting a standard letter has remained constant at 45 cents since 1992. However, during this period Australia Post has recorded strong profit performance and good productivity gains. This increase is probably due both to good management since corporatisation and to the protection provided by the reserved services. For example, since 1992, Australia Post has paid dividends of \$546.7 million and capital repayments of \$450 million to the Commonwealth Government. Treasury notes that:

AP's return on assets has increased each year since 1992-93, reaching 17.6 per cent during 1995-96, reflecting strong increases in its earnings. Between 1991-92 and 1995-96, AP's earnings before interest and tax increased by 62 per cent compared with average growth in total assets of 7 per cent. (Treasury, submission 52, p.19).

Australia Post's unusually high rate of return suggests that Australians may have been paying more for postal services than is necessary. The concern that customers were not benefiting from Australia Post's strong financial performance was raised in a number of submissions.

In competitive markets these benefits are more likely to be shared with customers through lower prices. As has occurred in the telecommunications industry, increased competition in the postal industry will encourage Australia Post to pass the benefits of any savings it can generate on to the consumer rather than the Government.

Postal services are one of the few essential services which affect the cost of nearly every business in Australia. Therefore, if postal services are not provided as efficiently as possible the cost will be felt by all other industries. The Industry Commission has estimated that if the price of posting business letters fell from 45 cents to 30 cents, 340 million more letters would be sent. In New Zealand, the threat of increased competition in the postal industry has resulted in New Zealand Post lowering its uniform rate.

3. *Increased innovation and responsiveness to customer needs*

While indirect competition from electronic communications has encouraged Australia Post to improve its services, telecommunications cannot provide substitutes for all postal services. Thus, the competitive pressure from electronic communications will vary according to the products and customers Australia Post serves. Not all customers will benefit from this competition as many customers still buy the kind of services only Australia Post provides.

Restrictions on competition imposed by the reserved services mean that innovation and the development of new types of postal services may be discouraged. According to the Major Mail Users Association, the:

... true growth of that [the hard-copy mail] market is stifled, albeit without ill-will or intention, in reaching its true potential because of the Act's restrictions and definitions (MMUA, submission 33, p. 13).

While Australia Post may be introducing new products and services, the protection over its reserved services can result in it not being as innovative in the letter segment of the market as it would be in a competitive market. It has been observed that:

A Post Office protected against the rigours of competition from new entrants has limited incentives to introduce new products or keep down the costs of existing services (Esrin and de Meza 1990, p. 2).

In addition, increased competition would encourage Australia Post (and other service providers) to respond more quickly to its customers' needs. A number of specific issues were raised with the Council in relation to Australia Post's delivery of postal services. The major areas identified include:

- the flexibility of Australia Post when dealing with its major customers;
- that performance measures on delivery do not cover business mail; and
- the quality of services in rural and remote areas.

Concerns have been raised that Australia Post responds very differently to customers depending on whether it is providing reserved or non-reserved services. With the reserved service there is less incentive to focus on customer satisfaction because only Australia Post is allowed to provide that service. Similarities can be observed in the telecommunications market. For example, competition in mobile phones has resulted in innovative tariffs and packages.

4. *Increased range of products*

One company cannot be expected to provide the full range of services that would be available in a competitive market. Companies that diversify too broadly can suffer problems and inefficiencies. In recent years companies have tended to focus more on their core activities and to divest themselves of non-core business. That is, to focus on what they do best.

This is not to suggest that Australia Post has diversified too far, but it is important to recognise that a company which tries to be all things to all people can become unmanageable. Competition will encourage Australia Post to focus its attention on those services which most suit its business. Those services outside that scope can be provided by other service providers.

Allowing competition would also provide the opportunity for companies, with expertise in different industries, to build on those skills to provide new enhanced postal services.

5. The Reform Package

Given the present pace of change it is timely and necessary to review the structural, institutional and regulatory framework covering Australia's postal industry. If Australia Post is shielded from the full effects of the changing market, through restrictions on competition, then there is a danger it may be relegated to a lesser role within the communications services market.

The complexities of Australia Post's business, the diverse needs of its customers and the complications of a changing communications environment require a comprehensive approach to reform. The Terms of Reference of this review and the postal service's fundamental social objectives provided the background for the Council's reform package. The Council has developed a strategic package which considers the postal

industry as a whole, the Australian community and Australia Post's role in the industry. This package is outlined in the executive summary in this volume and is compared with the package proposed by Australia Post. The core of the Council's package has the following key components:

1. retaining a uniform rate of postage for individuals and households posting standard letters;
2. retaining the Universal Service Obligation, with the Community Service Obligations fully funded;
3. retaining Australia Post's protection over household mail by requiring competitors to charge two times the standard letter rate for this mail;
4. Australia Post being free to offer discounts to business customers but with no business paying more than the uniform rate to post a standard letter; and
5. opening business and inwards international mail to competition.

In developing its recommendations, the Council has aimed for a package that would be practical;

- accommodate the strong public interest arguments for the universal service and the uniform rate of postage;
- maximise competition;
- maintain Australia Post as a viable postal services provider;
- minimise the cost of postal services;
- maximise growth in the postal industry and the benefits which flow through to the economy generally;
- maintain or enhance service levels; and
- contain the minimum regulation needed to support the package.

The Council's package of reforms will encourage a greater degree of competition in the postal services market, with significant benefits flowing to those buying postal services.

In constructing this reform package, the Council has drawn on the opinions, ideas and suggestions of interested groups and individuals. It has had access to a wide range of views, reflecting the diverse nature of those making submissions and attending meetings and workshops. Many of the ideas presented in these consultations have been adopted in the Council's reform package.

- The package has been formulated so that Australia Post will remain a viable enterprise and it provides for only a moderate increase in the share of the letter market open to competition compared to Australia Post's own proposal - although the part of the market which is opened to competition is different.
- It guarantees the community's social objectives of a universal service and a uniform price with only very limited need for the use of market restrictions to protect them.
- Job growth is likely to be encouraged in the telecommunications/postal sector.
- It is easily implemented and will simplify the legislation.
- It will give customers greater assurance of service quality while creating the opportunity for new competitors to offer new and innovative services, thus ensuring that postal services remain a vital part of the communications industry.

The remainder of this volume focuses on the components of the Council's package and its likely affects on different interest groups.

6. Community Objectives

The strong interest in this review from people representing community and rural groups indicates the importance of the community services provided by Australia Post. Australia Post is currently required to meet two social obligations: to provide a universal letter service and to apply a uniform rate of postage.

The postal services social objectives are contained in section 27 of the *Australian Postal Corporation Act* which states (in part) that :

- (1) Australia Post shall supply a letter service.
- (2) The principal purpose of the letter service is, by physical means:
 - (a) to carry, within Australia, letters that Australia Post has the exclusive right to carry; and
 - (b) to carry letters between Australia and places outside Australia.
- (3) Australia Post shall make the letter service available at a single uniform rate of postage for the carriage within Australia, by ordinary post, of letters that are standard postal articles.

- (4) Australia Post shall ensure:
 - (a) that, in view of the social importance of the letter service, the service is reasonably accessible to all people in Australia on an equitable basis, wherever they reside or carry on business; and
 - (b) the performance standards (including delivery times) for the letter service reasonably meet the social, industrial and commercial needs of the Australian community.

An important issue the Council considered is the extent to which established and emerging forms of electronic communication such as the telephone and the internet reduce or replace the need for a universal letter service. The Council's review identifies various areas where substituting a postal service with an electronic communications service is not a viable option. For example, the lack of reliability and reach of electronic communications is a problem for remote users. Further, some communications require a level of privacy and security that fax and e-mail communications cannot, as yet, provide.

Postal services will continue to be important to satisfy the communication needs of all Australians. It is necessary, therefore, to examine the postal Universal Service Obligation in detail.

The Universal Service

Section 27 of the Act requires Australia Post to deliver standard sized letters to all but the most remote parts of Australia, even if it would not choose to do so under normal commercial circumstances. This obligation to deliver almost universally within Australia is known as Australia Post's letter delivery Universal Service Obligation (USO).

The letter delivery USO consists of three elements:

- Australia Post must provide a letter service to almost all parts of Australia at a single uniform price (price element);
- it must make the letter service reasonably accessible to all Australians (access element); and
- it must meet reasonable performance standards in the delivery of letters (performance element).

In this report the Council distinguishes Australia Post's USO from its community service obligations (CSOs). The USO requires Australia Post to offer a postal service throughout Australia which in turn gives rise to some CSOs. CSOs arise when the Government requires a business to provide services which a private company would not choose to provide without compensation.

The letter USO has traditionally been supported on the basis that it assists in the "...social, industrial and commercial needs of communities and the development of the nation" (Vaile report, 1996, p. 27). The Council strongly supports the view that it is in the public interest for the USO to continue to be delivered as:

- the USO enhances social cohesion, as a nationwide, communications service is fundamental to people's business and social dealings;
- the existence of the USO enables communication to take place that would not otherwise occur;
- the existence of the USO promotes an Australia-wide postal network and guarantees the availability of postal services;
- the USO is consistent with the broader regional development aims of governments; and
- telecommunications services are not an adequate alternative.

Key Recommendation

The Council recommends the retention of the letter delivery USO because the CSO costs incurred are fully justified by the social benefits, and there is no effective alternative means of providing the social benefits (Section 6.2, Volume Two).

Uniform Price

The Council also supports the retention of the uniform rate of postage. The view of The Eastern and Central Regional Development Organisation was typical of the views expressed in many submissions:

... Australia Post must retain responsibility for the provision of the standard letter service at uniform costing to all Australians (Eastern and Central Regional Development Organisation, submission 28, p. 1).

It was also suggested by Australia Post and some LPOs that the cost of using postal services was less with a uniform rate:

The pricing system delivers simple outcomes to consumers and an administratively simpler system for Post to operate; that is, the current system has low transactions costs for all parties (Australia Post, submission 8, p. 78).

The Council agrees that there are social benefits from the availability of affordable postal services.

It was suggested by some that a maximum postal charge would be preferable to a uniform rate. The Council has considered this for both business customers and individuals.

The Council considers that it is important for business, and particularly small business, to have access to affordable postal services, and that Australia Post should not be restrained from offering discounts. The retention and expansion of discounts for business customers received strong support in submissions. The Council agrees that there would be significant gains to business from a more flexible discount structure, but that the price of a standard letter should be capped at the uniform rate.

In the case of household mail, however, only a couple of submissions advocated a change from the uniform rate. From a practical point of view the gains from moving to a maximum charge for household mail are likely to be modest. On balance, the Council recognises that there may be some advantages in moving to a maximum affordable charge but at this early stage it is difficult to predict the impact this would have on mail sent by individuals. Therefore, the Council has recommended that the uniform rate be retained and the desirability of moving to a maximum charge be reviewed in 2005.

Key Recommendation

The Council recommends that the uniform rate of postage apply to individuals and households posting standard size letters. Australia Post should be allowed to offer discounts to business customers, but no business should be charged more than the uniform rate for posting a standard size letter. The Government should review the possibility of introducing a maximum affordable charge for household letter services in 2005 (Section 6.3, Volume Two).

Defining the Letter Delivery USO

Once a decision has been made to ensure a universal service at a uniform price, it is necessary to look at the best way to determine the scope and quality of the service.

In the past, Australia Post has defined the USO internally. Under this approach, Australia Post issued operational manuals and internal guidelines to its staff. These guidelines were submitted to the Minister for the Department of Communications and the Arts each year and could be varied by the Minister.

This approach involves a conflict of interest. The requirement for the universal service is a government initiative, and part of government social policy. It is only an Australia Post's only obligation is to ensure as much as Australia Post must ensure its delivery. It is thus inappropriate that Australia Post should determine the quality of the USO. The potential risks will increase as postal services face increased competition from electronic communications. This competition will increase the pressure on Australia Post and increase the likelihood that its commercial objectives will conflict with its community service objectives.

Australia Post, in consultation with the community, is developing a service charter. According to its submission:

The Service Charter is designed to communicate clearly and simply the main standards and services the community is entitled to expect from Australia Post, the steps that can be taken if those expectations are not met, and sources of information and avenues of redress. The Charter will also briefly outline what customers can do to help Australia Post deliver such services (Australia Post, submission 8, p. 92).

The Council received considerable support for a stronger service charter.

Under section 28C of the Act, regulations can be put in place which prescribe performance standards for Australia Post. The Act also allows for the Auditor-General to audit and report on the extent to which Australia Post meets the performance standards. The Council considers that any matters set out in the service charter should reflect the performance obligations prescribed by the section 28C regulations.

Currently there are no regulations in place; however, the Department of Communications and the Arts is drafting such regulations. The Council considers that the regulations should cover all of the matters stipulated under section 27 in relation to the letter delivery USO - that is, access, price, and performance. More specifically, the regulations should cover matters such as access to stamps and posting points, speed, frequency, reliability, and security of letter delivery.

The service charter should be the means by which the public is broadly and clearly informed of Australia Post's performance obligations including guidelines on how to make a complaint about that performance.

Recommendations

The Council recommends that the regulations being developed under section 28C cover all aspects of Australia Post's letter delivery USO. The regulations should be developed jointly by a postal regulator and the Department of Communications and the Arts.

The role of the service charter should be to make Australia Post's obligations under the regulations clear to the public.

The Council recommends that a postal regulator monitor and report to Government on Australia Post's performance against the regulations, and recommend amendment as necessary. Australia Post should publish its performance against these measures annually (Section 6.5.1, Volume Two).

Scope of the Letter USO

There is confusion in the community about the USOs that Australia Post does or should provide. In meetings with the Council, and in submissions, parties raised a number of examples of services which they considered should be provided by Australia Post.

Given these concerns, the Council considered the need for, and feasibility of, the following additional USOs (see Section 6.6, Volume Two):

- a requirement for all post offices to provide financial services in all post offices;

- a requirement to deliver parcels Australia-wide; and
- a requirement to keep post offices open.

The Council recognises that all of these services are important to large groups of Australia Post's customers. A financial services USO was promoted in some submissions as a response to the closure of bank branches in rural and remote areas. The loss of bank branches has deprived some country people of easy access to banking services. To some extent, services offered by Australia Post have helped to fill this gap in banking services.

Several submissions also supported the concept of a parcel UCSO. For example, the NSW Farmers' Association stated:

The extension of the CSO to include parcel delivery to the roadside is justified on the basis that this is a basic service... (NSW Farmers' Federation, submission 124, p.2).

Others suggested that a USO should cover only the carriage of parcels containing health and educational materials.

Again, there were some submissions calling for the USO to be extended to cover post office access. For example, the CEPU wrote:

... the CEPU supports the proposal to include the following within a redefined CSO: ... access to the normal range of services via the provision of post office counter services in communities which meet specified criteria ... (CEPU, submission 127, p.36).

At the Council's workshop on CSOs, a broad range of community groups agreed that it was essential to maintain the letter USO but there was no need to have specific parcel and post office USOs. There was broad agreement that once the network is in place, by virtue of the letter USO, Australia Post will try to maximise its carriage of the amount of mail. Therefore, Australia Post will offer many services in addition to its letter service, including parcel deliveries, not just letters.

In the case of the financial services CSO, Australia Post has commercial incentives to offer financial services at most post offices, and has already done so. However, in some areas such a service is not viable because there are too few transactions.

Australia Post is not a bank, therefore, guarantees on such services should not be its responsibility. Australia Post only acts as an agent for financial institutions. On this point, the Council notes that the House of Representatives financial institutions and public administration committee, chaired by Mr David Hawker MP, is currently conducting a review of access to financial services in rural and remote areas. That inquiry is a more appropriate forum for further examining this issue.

Access and Performance

In Chapter Six of Volume Two of this report the Council considers in detail a number of aspects of the performance of the universal service which were raised during this review. The performance of the letter service includes delivery, who bears the cost, speed and reliability, and security of the mail.

As a result of its analysis the Council has made the following recommendations.

Recommendations

The Council recommends that the application of the new Rural Delivery Frequency Guide formula should be monitored to assess whether it is equitable in determining the number of deliveries to rural and remote postal users.

The Council recommends that Australia Post re-poll communities where, if abstentions had been ignored, the vote supporting an extension of delivery would have outnumbered the vote against extension. If a community vote is in favour of street delivery, people should have the option of requesting over-the-counter delivery at no cost to themselves.

The Council recommends that Australia Post ensure that the level of remuneration paid in respect of postal agency arrangements established in remote communities that receive mail by community bag is comparable to the remuneration that Australia Post would pay to a CPA/LPO and/or a contract deliverer to perform similar services.

The Council recommends that the annual fees in relation to private bags and locked bags should be abolished for all postal users receiving a delivery service less than a three times a week (Section 6.4.2, Volume Two).

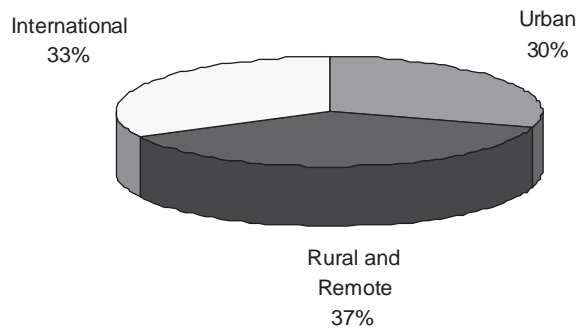
Cost of community service obligations

The unprofitable part of the letter delivery service consists of mail paths in the following areas:

- delivery to and from some rural and remote areas of Australia;
- some city to city delivery services; and
- some international mail.

Each of these areas represents about one third of the total CSO costs (see Section 7.2.2, Volume Two).

Source of CSO Costs



Source: Communication with Australia Post 1998.

Australia Post's assessment of the costs of CSOs

Australia Post measures its CSO costs by reference to the avoided cost methodology. In principle, this measures those costs Australia Post avoids if it does not provide the CSO service.

The Council considers this to be an appropriate methodology, although it has some concerns with comments on its application. In the Council's view it is likely that Australia Post's calculated CSO costs over-estimate the costs the Corporation would avoid without its universal service obligation (see Section 7.2.3, Volume Two). The CSO costing features which are of particular concern to the Council are:

- overhead costs, which account for almost 40 percent of the CSO, should not be that high because few overheads are sensitive to mail volumes;

Some myths about CSOs

The following are some common but inaccurate perceptions about Australia Post's obligations.

1. *There is an enormous cost involved in provision of CSOs, particularly CSOs to rural and remote areas.*

In 1995-96 the total cost of the CSO (as estimated by Australia Post) was \$67 million which means the loss per rural or remote person was estimated to be less than \$4.80 a year, less than the price of 11 letters. To put this cost in perspective, 4 billion letters and other articles were posted through Australia Post in 1995-96, an average of 222 articles for each person in Australia. The cost of providing CSOs to rural and remote areas in 1995-96 was less than \$25 million.

2. *CSOs are a large portion of Australia Post's total revenue and any expansion in CSOs would threaten Australia Post's viability/profitability.*

The cost of providing CSOs represents some 2.5 percent of total revenue (including non-letter revenue) or less than 21 percent of total profit in 1995-96 (\$67 million /\$344 million); and

3. *The beneficiary of the CSO is the recipient of the letter.*

The benefits of the CSO are shared by both the letter's recipient and its sender. Some mail (such as a cheque) is clearly more to the advantage of the recipient, but other mail (such as unsolicited advertising) is more to the advantage of the sender. Overall, CSOs benefit both parties. It is often residents of cities or regional centres who are sending letters to remote areas.

- the large component allocated to urban delivery (about one third) where delivery should be profitable;
- the CSO costs include all cases where letter delivery makes a loss. However, there may be circumstances where Australia Post would provide some loss-making services because it is in its commercial interest to provide (almost) universal coverage. This encourages greater use of the postal network by companies which want to send mail to a broad cross-section of the community. Those loss-making services Australia Post would choose to provide should not be part of the CSO; and
- the CSO costs use a rate of return on assets of 18.75 percent, as the Council believes is more appropriate, the estimated cost of the CSO would fall by \$10 million.

The Council suggests that the Government should independently assess the cost of CSOs before implementing any new funding arrangements.

Other Social Obligations

At the request of the Government, Australia Post provides services to some specific groups within the community at below the cost of provision. The services are:

- Freepost, which distributes braille literature free of charge to visually impaired and blind people. The Department of Social Security pays for this service; and
- delivery of mail at a concessional rate to Australian Navy and Army forces stationed at sea or overseas. The Department of Defence pays for this service.

These obligations are not discussed further in this report since there are no suggestions that they should be changed and the responsible department already directly funds the services.

Additionally, since 1989, the Government has directed Australia Post to provide, free of charge, pensioner mail redirection for the first month after a pensioner changes address. In 1995-96 Australia Post estimated that this Ministerial direction cost \$1.7 million.

Are Heritage Buildings a CSO cost?

Australia Post has argued that the community expects the “preservation in postal use, and restoration, of General Post Offices; and other Post Offices which have local historic significance” (Australia Post, submission 99, p. 90). However, it does not support the creation of a heritage building obligation. According to Australia Post, it “should not be bound to ongoing use and/or ownership of heritage buildings” (Australia Post, submission 99, p. 59).

Like all owners of heritage-listed properties, Australia Post has obligations under the Australian Heritage Commission Act 1975 (the AHC Act), and related legislation. Under the AHC Act, owners of heritage buildings cannot take any action which would adversely affect the building, unless there is no “feasible and prudent” alternative. Any unavoidable action that an owner does take must have minimal impact. Owners must seek the Heritage Commission’s advice on any proposed action.

Australia Post owns 155 heritage listed properties and therefore it believes that its AHC Act obligations are particularly heavy. Further, Australia Post argues that there is considerable public and political pressure on it to retain those buildings as post offices (Australia Post, submission 99, p. 58).

An obligation is not a CSO if the Government requires all businesses, in both the public and private sectors, to undertake the activity. Under the AHC Act, Australia Post’s obligations are the same as any private sector organisation which owns a heritage listed building (for example, banks). Therefore, its AHC Act obligations do not currently constitute a CSO.

The Council considers that it is appropriate that heritage obligations be dealt with under heritage legislation and not the Australian Postal Corporation Act. In addition, the obligations should continue to apply equally to all owners of heritage-listed property and Australia Post should not be subject to a specific CSO obligation (Section 7.3.1, Volume Two).

Funding Australia Post’s CSO

As noted earlier, the costs of the CSO are currently funded through a cross-subsidy. The Government’s general policy on funding social obligations is that it prefers to fund CSOs by direct payment. In relation to CSOs which arise out of a requirement

to provide a universal service (such as Australia Post's letter delivery CSO), the Government has not adopted a committed policy position.

Australia Post believes that the cross-subsidy method is the best way to fund CSOs. It argues that cross-subsidy arrangements are:

- easy to administer; and
- facilitate a uniform rate of postage across Australia, which fulfils equity considerations and simplifies assessment of postal charges for letters.

However, the Council's approach to retaining reserved services for mail sent by individuals and households guarantees the uniform rate of postage without the need to rely totally on cross-subsidies. Also, the cost of administering funding under a cross-subsidy increases significantly once the effort is taken to define and cost the CSOs clearly. Once the need to define CSOs is accepted, the cost of administering a cross-subsidy is much closer to the costs of other forms of funding.

The disadvantages of cross-subsidy arrangements include:

- the tensions between Australia Post's commercial obligations and its CSOs;
- they are less transparent;
- cross-subsidy pricing is inefficient; and
- they require restrictions on competition.

The analysis in Section 7.4.1 of Volume Two discusses each of these problems and notes that many of them can be overcome using alternative methods of funding. Other methods of funding CSOs include:

- the Government, as owner, accepting a lower rate of return;
- levies on other service providers; and
- direct budgetary payments by the Government.

Accepting a Lower Rate Of Return

This requires Australia Post to negotiate with the Department of Finance (on behalf of the Commonwealth) a rate of return on its assets adjusted to take account of the losses sustained through the provision of CSOs. The adjusted rate would be below a commercial rate of return.

A number of submissions argued that this approach is not an appropriate way to fund the CSOs because:

- *[a lower rate of return] doesn't encourage Australia Post to seek a commercial rate of return on its assets (POAAL, submission 84, p. 21).*
- *a lower rate of return on assets ... distorts management information and decision-making, and clouds external evaluation of Australia Post's performance (ACCI, submission 85, p. 9).*
- *[a lower rate of return] distorts essential financial information required by management and is inconsistent with GBEs, such as Australia Post, operating on a commercial basis (ACCI, submission 45, p. 38).*

The Council agrees with these views and has concluded that a lower rate of return is not the best way to fund the CSOs.

Levies on other service providers

This model for funding CSOs requires each service provider competing in the market to provide a contribution to the total cost of the CSO. The contribution would be calculated according to market share or according to the profit generated by the service provider, including Australia Post. Australia Post would then provide all the CSO services but would be entitled to funding from the pool of contributions.

A model similar to this was used to fund CSOs in the telecommunications industry prior to June 1997.

The advantages of this model's pluses include:

- the funding method does not impede competition in the market;
- it provides a level playing field for competition (since one participant, Australia Post, is not left to shoulder the full burden of providing CSOs); and
- it provides a secure source of funding for CSOs that is not vulnerable to budget cuts.

Challenges posed by the introduction of an industry levy are:

- it is difficult in postal services to isolate an objective measure of activity (eg market share or volume) on which to calculate a company's contribution to the CSO. The measure should ideally be both practical to measure and reflect the competitor's share of the postal market;
- Australia Post may not have strong incentives to seek to provide CSO services at the most efficient cost if it knows that it would, in any event, be compensated for the full cost of provision; and
- the levy would mean that, competition would not result in prices falling as much as they would if the Government funded the CSO directly from the budget. All service providers, including Australia Post, would need to raise their prices to cover the cost of their levy contribution. The levy would need to be administered effectively to minimise the increase in prices.

The Council considers that these problems can be overcome by an industry levy with the following components:

- service providers (that is, competitors in the market) would be required to be licensed to deliver letters. The licence should only apply to the carriage of standard sized letters;
- service providers would be required to pay a licence fee as a contribution to the funding of the CSO;
- the licence fee could be based on the volume of letter business undertaken by the service provider. For simplicity, the licence fee could be set as a number of increments according to broad measures of the size of the business, so that as the volumes carried by the service provider grow, at particular steps a new increment would apply. Total fees paid by all Australia Post's competitors would equate with their share of the market. For example, if they captured 20 percent of the market, they would pay 20 percent of the total CSO costs;
- the fee could be paid in advance and then adjusted periodically. For example, the fee could be set every five years in advance, and paid in annual instalments;
- the fee could be set low during the first five years of operation so as not to discourage competitors from entering the letter delivery market,

and then increased. In order not to catch service providers by surprise, they should be informed in advance of the level of both the initial and increased fee;

- the fee could be audited at random to prevent understatement of volumes with penalties including fines and the revocation of the licence for any party that was caught understating volumes. One option could be for service providers to be able to choose to install secure metering devices to reduce their audit obligations;
- the fee could be paid into a common pool from which Australia Post, as the party required to provide the USO, would be entitled to draw. Australia Post's entitlement could be assessed from the audited cost of the CSOs; and
- the system of licensing, assessment, and enforcement should be managed by an independent body. Chapter Nine of Volume Two discusses the appropriateness of different institutional arrangements.

Direct Budgetary Payments

This requires the Government to make an explicit payment to Australia Post to meet the cost of its CSOs. This payment would be based on negotiations between Australia Post and the Government. The payment could be made in arrears, on proof of expenditure, or in advance for one or more years.

Direct funding has the following advantages:

- it allows for the introduction of competition into the provision of all postal services while still ensuring that money is available to cover the costs of the CSOs;
- it provides information which allows an assessment of whether services are being targeted at those who need them; and
- it provides the information needed to assess whether the services are being provided in a way which represents value for money.

Some submissions raised concerns about the consequences of direct funding. These concerns, and the Council's response to them, are outlined below.

Reduced incentives to provide CSOs efficiently

Some argued that if Australia Post's CSOs are funded by direct budgetary payments then this would reduce its incentives to provide CSOs efficiently since Australia Post would know that its costs of provision would be fully funded.

However, as many aspects of Australia Post's CSO services are already contracted out (eg some rural and remote area deliveries) accurate costs of these services are already available. As an additional safeguard the Government could independently audit the cost of Australia Post's CSOs when setting the appropriate level of funding. Further, if the CSO payment is made in advance there would still be strong incentives for Australia Post to reduce its costs to retain any savings made.

Costs associated with direct budgetary funding

All forms of funding result in money being collected from one group in order to provide the CSOs to others. Therefore, funding CSOs will always impose a tax on those who pay prices in excess of costs in order to help fund the high cost services. It is likely that the impact of this tax will be less when it is spread across the whole community (that is, collected through general tax revenue) than when it is collected from a group of postal users.

Vulnerability of funding

A number of submissions expressed the fear that if CSOs are funded from consolidated revenue, then they could be cut by Parliament during the budgetary process. Typical of these was:

... there is little evidence to suggest that where public sector organisations have been relieved of CSOs that these same CSOs have been directly replaced by transfers. It appears that the nexus becomes lost and funding for the CSO enters competition with the whole range of competing demands on government finances (Local Government and Shires Associations of NSW, submission 47, p. 3).

In the case of postal services, some CSOs have been funded by direct budgetary payments for some time. Given that the cost of the letter delivery CSO is small

compared with the strength of community support for its retention there would be strong political pressure against payments being reduced in the budget process.

In addition, there are ways of safe-guarding the funding of CSOs where they are directly funded. The funding of CSOs can be linked to the service standards in the service charter, such that the level of funding could not be cut in circumstances where this might threaten Australia Post's ability to meet the required service standard. Also, by setting the funding up-front for a period of, say, five years, the CSOs can be guaranteed for an extended period of time.

Through these methods, the Council considers that it is possible to overcome the problems associated with threats to the continued funding of CSOs. In the light of these safeguards, and bearing in mind the significant advantages of direct funding, the Council recommends the direct budgetary funding option for CSOs. However, if direct budget funding is not adopted the Council considers that an industry levy is the next best means of funding the CSOs.

Key Recommendation

The Council recommends funding of the CSO by direct budgetary payments (Section 7.4.4, Volume Two).

Level of funding

The level of funding needs to be sufficient to compensate Australia Post for the provision of the CSOs without providing it with an advantage over competitors by providing more money than is necessary to cover CSO costs.

Under direct budget funding the Council considers that the Government should negotiate the CSO funding in advance for five years. This would provide certainty of funding and incentives for Australia Post to reduce the costs of providing the CSO services. During the five year period, Australia Post should be free to retain any extra profits earned by making savings in the provision of the CSOs, on the understanding that the postal regulator will monitor service standards to ensure that Australia Post is maintaining an acceptable standard of delivery.

The maintenance of the uniform rate of postage also needs to be taken into account when calculating the CSO funding. Australia Post would still be able to cross-subsidise some of its loss-making services out of the profits earned on the remaining reserved services. While these profits would not cover all of the costs of the CSOs, they would make a significant contribution. Therefore, to assess the amount of CSO funding it is necessary to:

1. assess the avoidable cost of the CSO services; and
2. discount this avoidable cost by the amount of extra profits Australia Post earns on the non-CSO component of the remaining reserved services.

Key Recommendation

The Council recommends that the Government negotiate CSO funding in advance for five year periods (Section 7.4.5, Volume Two).

Contracting out CSOs

At present, a number of CSO postal delivery services are contracted out by Australia Post, including roadside mail delivery in rural and remote locations, and the services of Licensed Post Offices (contracting out more generally is discussed in Chapter Eleven in Volume Two). Australia Post contracts out these services in areas where it considers that cost savings might be made.

The contracting out of such services has attracted some concerns as well as some support. For example, according to the NSW Farmers' Federation:

A persistent comment is that the incidence of misdirected mail has increased where an agent has taken over postal service responsibility. Inaccuracy... particularly impacts on rural people given that some areas of NSW only receive one mail delivery per week (NSW Farmers' Federation, submission 31, p. 3).

In contrast, the Eastern and Central Regional Development Organisation observed:

There was general regional satisfaction over the contracting out of services and the operation of licensed retail outlets. The

quality and level of customer service provided by Licensed Post Offices in rural towns was favourably commented on by their representative communities (Eastern and Central Regional Development Organisation, submission 28, p. 1).

The view from the majority of submissions seemed to be that while there were some initial teething problems, these usually have been addressed as the contractor acquired more experience and that, overall, the services provided by contractors were good.

The Council considers that with adequate monitoring of contract arrangements, Australia Post should be able to ensure that contractors meet their contractual responsibilities.

While the Council considers that there may be some scope to further pursue contracting out strategies for CSO services, it has not made any recommendations in this regard because Australia Post already has commercial incentives to pursue opportunities to contract out.

This leaves the broader question of whether the Commonwealth Government should contract out the provision of CSOs and require Australia Post to compete with other companies to provide these services. The Council has concluded that this approach is not feasible because:

- it is difficult to draw a line around all CSO activities and separate them from profit-making activities; and
- Australia Post is currently the only provider with a universal network and with sufficient economies of scope and scale to provide the services at minimum cost. It is possible that, at this stage, an open tender would mean that the Government would pay a higher price for the CSO services than it does now.

The Council considers that if competitors are able to enter the market and grow to a reasonable size, they may be able to tender at a competitive price. However, at present, contracting out CSO activities is not likely to produce cost savings.

Recommendation

The Council recommends that the Government should not seek to contract out CSO activities at this stage but that this policy should be reviewed in 2005 (Section 7.5, Volume Two).

7. Increasing Competition

Reserved Services

Competition in postal services is obviously restricted by the Act, which reserves to Australia Post the exclusive rights to provide certain services. These services include the collection and delivery of all letters weighing no more than 250g, letters carried for a fee of less than \$1.80 and all inward bound international letters. The Act also specifies a number of exemptions to the reserved services, including the carriage of books, newspapers, magazines, catalogues and leaflets, carriage of a letter relating to goods that is sent with the goods, letters sent and received within a document exchange and the carriage of writs and other legal documents.

Products Covered By The Reserved Services Provisions

Domestic mail

Standard and large letters - weighing up to 250 grams or for which the fee is up to four times the standard letter rate (\$1.80). At present, Australia Post's charges for large letters weighing up to 250 grams are all less than \$1.80. Special products in these categories include the following.

Discounted products linked to the prices of the standard and large letters (up to 250 grams) such as:

- seasonal greeting cards;
- pre-sort discounts (including interconnection);
- advertising mail discounts; and
- local delivery discounts.

Mail with special services attached such as:

- postage pre-paid envelopes;
- certified mail;
- acknowledgment of delivery; and
- reply paid.

International mail

Inward bound letters

Postage Stamps

Australia Post also has the exclusive right to issue postage stamps within Australia.

Introducing more competition

In Section Four, the Council discusses the benefits that can be achieved with competition. The Council's public consultation process revealed a widely held view that the benefits of competition will accrue primarily in the business mail sector. At the same time, the Council is mindful of the need to protect the social obligations provided by Australia Post and that the restrictions on competition are currently the means to ensuring this protection.

The main impediments to competition are the uniform price requirement and the use of the cross-subsidy to fund the CSO.

As discussed above, it is both possible and desirable to fund the community service obligation (CSO) other than by cross-subsidy. On the other hand, the maintenance of the uniform rate of postage for household mail will still require some market restrictions to prevent competitors undercutting Australia Post's price in low cost markets and undermining the uniform rate.

This implies that it is necessary to retain the reserved services over those postal services covered by the uniform rate. It is then possible to open all other areas - principally business mail - to competition. To guarantee protection of the uniform rate, the Council recommends that the threshold for competition should be two times the standard letter rate.

Key Recommendation

The Council recommends that business mail should be opened to competition. The minimum competitors can charge for those letters which remain in the monopoly (household mail) should be two times the standard letter rate (Section 8.4.1 Volume Two).

Letter and Reserved Services Definition

The Council has recommended that only standard postal articles that cost less than two times the uniform rate, and do not originate from business, should be reserved to Australia Post. The Council has considered various suggestions for how this result can best be achieved (Section 8.4.2, Volume Two). One suggestion that would simplify the Act and encompass the Council's recommendations would be to amend

the letter definition set out in section 3 of the Act, in respect of the letter definition to read:

“letter” means a **standard postal article** that contains an addressed written communication.

In addition, section 27(2)(a) could be amended to replace the words “to carry, within Australia, letters that Australia Post has the exclusive right to carry; and” with:

(a) to carry, within Australia, **letters**; and

Section 29 could be amended to read:

Services reserved to Australia Post

- (1) Australia Post has the exclusive right to carry letters for a fee or charge, other than **exempt letters**, within Australia.
- (2) For the purposes of this section, a letter is an **exempt letter** if the letter:
 - (a) is one that costs at least two times the fee or charge that Australia Post imposes for the carriage of a standard postal article; or
 - (b) originates from a **business**.
- (3) In this section, business includes a **business** not carried on for a profit.

Section 30 of the Act, which contains exemptions to the reserved services, would be repealed.

The Council considers that ‘business’ includes charities, non-profit organisations, corporate bodies, partnerships, associations, agencies, public institutions and others involved in commerce and industry.

Cost of Postage

Australia Post currently charges 45 cents for delivery of a standard sized letter to almost anywhere in Australia.

Australia Post has observed that:

Australia's basic postage rate is the third lowest in the Western World (Australia Post, submission 99, p, 18).

Evidence to this review confirmed the view that 45 cents represents good value to household customers and that these customers are more concerned that the quality of the universal service be retained, than that the price fall below 45 cents.

Those customers most sensitive to price are business customers. Their concerns are addressed by other parts of the Council's reform package.

Accordingly, the Council does not consider it is appropriate to recommend a change in the present rate of 45 cents. On the other hand, Australia Post should be free to lower the standard letter rate if it wishes to or apply to the ACCC if it wishes to increase prices (see Section 9.6, Volume Two on price regulation).

Recommendation

The current rate of postage of 45 cents should remain if the Council's recommendation to deregulate business mail is adopted. Australia Post should be free to lower the rate of postage below the current rate if it wishes (Section 8.5.6, Volume Two).

Postage Stamps

Australia Post also has an exclusive right to issue postage stamps.

The monopoly on the issuing of postage stamps has two aspects. First, postage stamps are proof of prepayment for postal services. Second, stamps are collectors' items. The Council's discussion in Chapter Eight of Volume Two concludes that neither of these rights have effects which restrict competition (see Section 8.4.3, Volume Two).

On the first aspect, competitors can choose many ways to charge for their services and are not restricted by Australia Post's right to issue stamps.

On the second, Australia Post faces competition from postage stamps from other countries and other collectibles and, therefore, has no real advantage beyond what can be expected with trademark brands or copyrights.

Therefore, there do not appear to be any substantial competition or competitive neutrality issues in the postage stamp monopoly.

Resale price maintenance

The Act allows Australia Post to specify the prices at which stamps must be sold. Otherwise, any attempt by Australia Post to Without this provision, preventing people from discounting stamps would contravene the resale price maintenance provisions in the Trade Practices Act.

The Council believes that to maintain the Government's uniform price objective the general discounting of stamps is not appropriate. However, the market for postal services should undergo significant change following the increase in competition. It therefore would be appropriate to review the benefits and costs of resale price maintenance in 2005 at the same time as the uniform rate of postage.

Recommendation

The Council recommends that the exception to the resale price maintenance provisions be reviewed in conjunction with the review of the uniform rate of postage in 2005 (Section 8.4.3, Volume Two).

Posting Boxes

Several of the submissions to the review have suggested that Australia Post gains an advantage from its right to erect street posting boxes. While the ability to erect such boxes is not reserved to Australia Post, section 95 of the Act confers on Australia Post the right to erect, maintain and use street boxes, regardless of other regulatory restrictions such as local planning.

Extending the right to erect collection boxes to competitors or requiring Australia Post to allow access to its boxes are unnecessarily complex ways of dealing with this issue. The Council appreciates that the ability of the community to access postal

services is an important aspect of the Universal Service Obligation. While it is not possible to guarantee that street posting boxes are used only for reserved services, it is possible to remove Australia Post's advantage for new boxes targeted specifically at non-reserved services. The Council therefore recommends that the right to erect posting boxes be maintained but be restricted to the ordinary red posting boxes suitable for posting standard letters.

Recommendation

The Council recommends that the right of Australia Post to erect posting boxes should be maintained for the ordinary red posting boxes suitable for posting standard letters. Otherwise, Australia Post should be subject to the same requirements as other postal services providers (Section 8.4.4, Volume Two).

This recommendation does not impede the ability of any operator to negotiate with the relevant authorities to erect street posting boxes or other collection facilities. The effect would be simply to put Australia Post on the same footing as other operators in respect to street collection of items not covered by the reserved services.

International mail

International mail, while constituting a small proportion of Australia Post's mail (around seven percent) is responsible for a significant part of the CSO. This is a consequence of the payments system for dealing with international mail known as terminal dues².

While outward bound international mail is open to competition, delivery of inward international mail is reserved to Australia Post. Inward mail is either paid for at the appropriate Universal Postal Union (UPU) rates (for other UPU members) or at the domestic letter rate for non-UPU members. The CSO arises because the UPU rates provide inadequate compensation to Australia Post for the delivery of incoming international mail.

Deregulating inward international mail, therefore, is likely to benefit Australia Post. This is because any competitor bringing international mail into Australia is likely to

lodge it with Australia Post for final delivery. In doing so the competitor would pay Australia Post the domestic postal rates which are more than the rates paid by the UPU. If a competitor chooses to complete the delivery itself, Australia Post would also benefit because it would not incur the expense of delivering the loss-making mail.

The Council considers that the international inwards mail market should be opened to competition.

Key Recommendation

The Council recommends that inward international mail be opened to competition (Section 8.4.5, Volume Two).

Contracting Out

The Council notes there are benefits from contracting out and leasing, particularly where competition is limited. Australia Post has pursued contracting out in many areas, most visibly in its retail operations. While there seem to be some problems at the local level with the contracting out process, the high customer regard for many of the contractors, including LPOs, suggests that overall the process works well.

There may be scope for further extending the contracting out of some activities - such as the LPOs. However, this would need to proceed with industrial relations issues in mind. Increasing the number of LPOs also would address those unresolved issues of equity and fairness which exist between the present mixture of corporate and LPOs.

In terms of contracting out and leasing generally, however, the decisions are commercial ones for Australia Post. It is unlikely that any external body would be in a position to judge the appropriate levels of contracting out.

2 The system of terminal dues is administered by the Universal Postal Union (UPU), a specialised United Nations' institution which regulates international postal services. Terminal dues operate as a system of clearances for settlement of accounts between postal administrations for inter-administration charges related to the exchange of postal items and international reply coupons. When a country has an excess of inwards mail over outwards mail, that country has the right to collect a payment for the costs of delivering the excess international mail. Conversely, administrations with an excess of outward mail make a payment for its delivery. The level of payment is set at the average cost of delivery across all countries. Despite recent increases, the rates are still well below Australia Post's cost of delivery.

In a more open competitive environment, the constraints on Australia Post's freedom to make its own business decisions need to be minimised. Contracting out is just one of the ways Australia Post can respond to the challenges of the changing market.

8. How to Manage Increased Competition

The Council's recommendations on increasing competition while maintaining the uniform rate of postage and the universal service will affect the postal services industry and the way companies operate within that industry. Further measures are needed to ensure that competing service providers are not able to benefit by free-riding on Australia Post's comprehensive services, and also to ensure that Australia Post cannot suppress competition by exploiting its market power and position as universal service provider.

In Chapter Nine, the Council considers industry self-regulation but concludes that without any regulatory oversight, it would not achieve the outcomes expected by consumers and industry stakeholders.

To address these issues the Council proposes a package of regulation for the postal services industry. The following sections discuss the type and level of regulation required in order to:

- oversee and monitor the USOs, Australia Post's service charter and any industry codes of practice and industry standards;
- address customer complaints; and
- address any anti-competitive conduct by Australia Post.

To monitor these industry protocols, and to oversee competition and customer service in the postal services industry, the regulatory package includes the Commonwealth Ombudsman, the Australian Communications Authority (ACA) and the Australian Competition and Consumer Commission (ACCC). The role of each of these regulatory agencies is discussed below.

USOs and Consumer Standards

Many of the submissions noted that Australia Post provides a high quality service. The Council is aware that service quality and standards are important to the consumer. As discussed in Chapter Nine, the Council's reform package combines the benefits

of self-regulation with the oversight and certainty of an independent regulator. This combination, plus the ability of a customer to demand satisfaction in a competitive environment, all ensure service quality and standards will be maintained.

Industry self-regulation

There are a number of practical issues that arise in the day-to-day management of the postal industry which need to be addressed prior to the introduction of competition. Industry codes and standards are important in dealing with practical issues including redirected mail or 'dead' letters, security and privacy of postal articles, the protection of personal information, holding mail for customers and return-to-sender letters.

All of these procedures will be important in a competitive postal industry. As noted by Australia Post on one of the practical issues which must be addressed:

In 1996/97, more than 100 million letters were returned to sender (RTS). These were returned using the sender's address if printed on the outside of the envelope, or if not, by an Australia Post dead-letter office authorised to open mail (Australia Post, submission 99, p. 21).

Further, maintaining the security and privacy of postal articles will be crucial to ensuring the integrity of postal services. As Australia Post observed:

Letters often contain the most private and confidential information about persons and businesses. This includes personal financial, medical and legal details, which if compromised could cause severe embarrassment or damage to the persons concerned (Australia Post, submission 99, p. 22).

The Council considers that if service providers are to conduct their business with each other and with their customers efficiently and effectively, it is important that industry protocols are agreed between, and maintained by, all industry participants. For example, it may be necessary for postal service providers to establish a national database to allow them to access and record mail redirection and change of address information. Further, formal arrangements may also need to be in place to assign responsibility for return-to-sender, damaged or delayed letters. One option is for other service providers to pay Australia Post to provide some of these services.

Postal industry regulator

To ensure the efficacy of the industry protocols, the Council considers that the voluntary arrangements should be supported by a regulator with the power to establish and enforce mandatory industry standards where appropriate.

In determining the agency best suited for this role, the Council examined existing agencies with functions and expertise similar to those required by a postal services regulator. The Council considers that the Australian Communications Authority (ACA) is best equipped for the role.

The ACA is the regulator responsible for consumer and technical matters concerning telecommunications. Relevant to the Council's recommendation is the ACA's previous role as a regulator responsible for competition, consumer and technical matters in a newly deregulating industry between 1989 and 1997³. The ACA's current role as an industry specific regulator includes responsibility for matters such as:

- USO administration and compliance (for telecommunications);
- licensing of telecommunications service providers; and
- industry codes of practice and standards affecting consumers and telecommunications industry stakeholders.

Many submissions supported the ACA being appointed as the postal service regulator. For example, Readers Digest noted that:

Whilst setting up a new regulator may be an ideal option but costly, broadening the Australian Communications Authority to include postal services would seem to have advantages (Readers Digest, submission 116, p. 4).

The telecommunications industry provides an example of how the regime would work. In that industry, participants are responsible for developing a service charter with which they must comply and by which customers can measure their performance. The service charter must be approved by the ACA which is also responsible for monitoring industry performance under the charter. Industry codes of practice and/or industry standards also can set the parameters by which industry participants provide their service. Compliance with these codes and standards also is monitored by the ACA.

3

The ACA was established in 1997 through the merger of AUSTEL with the Spectrum Management Authority. AUSTEL's competition functions went to the ACCC.

Recommendation

The Council recommends that in a deregulated postal services market, the ACA administer postal services regulation outside the ambit of the ACCC. Specifically, the ACA's charter should be expanded to give it responsibility for administering:

- **the assessment and funding of the postal CSO, if there is an industry levy;**
- **monitoring systemic issues associated with Australia Post's compliance with the CSO;**
- **enforcing CSO compliance;**
- **licensing of Australia Post and other postal service providers;**
- **monitoring and enforcing compliance with postal service provider licences; and**
- **administering the establishment and enforcement of industry codes of practice covering service standards (Section 9.7.2, Volume Two).**

The ACA's responsibility for administering arrangements for the establishment of voluntary industry codes of practice should cover protocols for dealing with:

- redirection and holding of mail;
- return-to-sender letters;
- security and privacy of postal articles;
- lost, damaged and delayed mail;
- technical aspects of interconnection not dealt with by the ACCC; and
- the internal handling of consumer complaints by postal service providers and, if necessary, an industry scheme for complaints handling and resolution.

The Council also envisages that the ACA would have a broad role in raising consumer awareness about reform of the postal services market and related issues affecting users and providers of postal services.

Finally, in order for the industry protocols to be effective in a competitive market, it is important they be in place prior to market liberalisation. In the event they are not

in place, the Council considers that the ACA should determine the appropriate standards and codes of practice.

Recommendation

The Council recommends that if the protocols *critical* to protecting customers and enabling interconnection to function are not in place at the time of market liberalisation, the regulator for postal services should itself determine standards applicable to such matters, in consultation with stakeholders. This should occur within six months of market liberalisation (Section 9.7.1, Volume Two).

The role of the ACA, therefore, will be to oversee and monitor Australia Post to ensure it is complying with its USO, and all industry participants to ensure they are complying with their obligations under the industry codes and standards.

Customer complaints

While the ACA should be responsible for overseeing and monitoring postal industry services and the Universal Service Obligation, the Council believes it is important to have in place a forum to which individual customers can direct complaints. The reform package recommends that the complaints mechanism be set out clearly in Australia Post's service charter.

As Australia Post is a government owned corporation, unresolved complaints about its service are currently directed to the Commonwealth Ombudsman. The Commonwealth Ombudsman has created a position of Senior Assistant Ombudsman with responsibility for dealing with complaints in relation to Australia Post. According to the Ombudsman's office, the office received 654 complaints about Australia Post in 1995-96.

The Council considers that in view of:

- the Council's proposal to retain the reserved service for residential customers; and
- Australia Post's position as the sole USO postal service provider,

the Commonwealth Ombudsman should continue to deal with individual complaints about non-compliance with the USO and complaints made by individuals on the delivery of services by Australia Post.

Recommendation

The Commonwealth Ombudsman should continue to deal with individual complaints about Australia Post’s non-compliance with the USO (discussed in Section 9.7.1, Volume Two).

Australia’s Universal Postal Union Obligations

Australia is a member of the Universal Postal Union (UPU) and, therefore, is subject to international treaty obligations arising under UPU Conventions and Agreements. The UPU provides for harmonisation and simplification of international mail procedures, as well as technical co-operation and development, quality standards and security regarding international mail delivery.

According to one commentator:

To enable their postal administrations to provide universal worldwide delivery services, national governments maintain membership in an intergovernmental organisation, the Universal Postal Union. The UPU is a specialized agency of the United Nations which governs and develops the basic international services their governments expect their postal administrations to provide to citizens and businesses (Leavey 1993, p. 3).

Australia’s UPU obligations are currently managed by Australia Post and the Department of Communications and the Arts. Australia Post pays for Australian membership of the UPU. The Department of Communications and the Arts provides for overall coordination of government policy in postal matters and Australia’s UPU membership responsibilities. Australia Post has responsibility for operational and commercial matters arising out of UPU membership. This includes representing Australia on the Postal Operations Council, a technical and operational body of the UPU, and in respect of obligations arising from UPU Conventions and Agreements.

Some submissions queried whether Australia Post should have such a significant degree of influence in government policy or participate at the level it does in UPU activities.

The Council considers that given that the UPU obligations are those of the Australian Government, as signatory to UPU treaties, and do not involve direct regulation of private postal service providers, it is appropriate that the Department of Communications and the Arts continues to manage Australia's UPU obligations. The Council has concluded also that as Australia Post is the only body able to provide a universal service it should continue to be the designated official postal administration under the UPU.

However, in performing its role, and specifically in assigning Australia Post responsibility for representing Australia in matters arising out of UPU membership, the Department of Communications and the Arts should have regard to arrangements which permit private postal service provider input to UPU matters, where appropriate, once a more liberalised postal services market is established.

Recommendation

The Council recommends that Australia Post should continue to be designated as Australia's official postal administration to the UPU. This should be reviewed in 2005 having regard to the ability of private postal service providers to supply a universal service (Section 9.7.1, Volume Two).

How to address anti-competitive conduct

Australia Post is currently subject to all provisions of the TPA, other than Part IIIA. The Council has considered whether the existing provisions of the TPA will be effective in safeguarding competition in a deregulated postal industry. In particular, it has considered the issues raised by various parties who are concerned that Australia Post's present level of market power would discourage, or even preclude, other companies from entering the postal services market and competing on an equal basis.

Australia Post's strength in the postal services market

Australia Post's status as the official provider of postal services means it has considerable strength in the postal services market. Australia Post has the advantages of a well established network, a strong relationship with customers and a reputation which would make it difficult, at least initially, for new providers to compete.

Dominance of a market by an incumbent can be reduced through deregulation and, if appropriate, supporting regulatory arrangements. For example, Telstra's dominance in the market for mobile telephone services has been reduced through the licensing of competing mobile telephone service carriers and the establishment of access and other regulatory arrangements.

Several competitors noted that Australia Post's comprehensive network provided it with a significant competitive advantage. For example, according to TNT:

Experience with the deregulation of other public sector monopoly utilities has amply demonstrated that customer inertia against a background of lifelong experience with a single service provider with a highly recognised brand name cannot be over-estimated. Moreover, the comprehensive delivery network operated by every postal service incumbent represents a significant competitive advantage and a source of economies of scale and scope (TNT, submission 43, p. 1).

While Australia Post's established network, brand name and role as the CSO provider will give it a clear initial advantage in a more liberalised postal services market, the Council does not consider this advantage to be insurmountable. The costs of establishing a postal business are not high, making it relatively easy for a business to set up in competition with Australia Post. This is evidenced by the fact that already there are in place a number of market participants. Also, Streetfile, TNT and Mayne Nickless have indicated they would increase their involvement in the postal market if the letter service reservation is removed or reduced.

In addition, competition in the business segment of the letter market is likely to attract a number of niche market operators. Arthur Andersen noted:

While it is unlikely that any competitor will fully replicate Australia Post's network, it is feasible for existing market players to integrate their networks with each other and bypass most of

Australia Post's network - especially on the termination end of a service (Arthur Andersen 1998, p. 23).

Further, there is some competition already from electronic communications services and this competition is likely to increase.

The difficulty for competitors will arise in attracting customers away from Australia Post, particularly given the level of customer satisfaction with Australia Post's service and Australia Post's detailed knowledge of the mail sent by all large customers. The Council's package of reform has been designed to balance the competing interests of allowing new competition to emerge while not unnecessarily restricting Australia Post's ability to compete.

Is access regulation necessary?

The current access arrangements require Australia Post to offer discounts for bulk mail users wishing to interconnect with its network by lodging mail in the state where it is to be delivered. The ACCC has the power to inquire into a dispute over interconnection, and to report to the Minister to resolve such disputes.

Many users have criticised the structure of the current access arrangements arguing that they offer users insufficient discounts to make interconnection worthwhile. According to major users, Australia Post is only able to extract these terms and conditions because of its current statutory monopoly.

It is likely that future competition for the provision of postal services for business customers will be focussed, at least initially, in metropolitan areas and provincial cities. Competitors are likely to target high volume customers in order to generate the economies necessary to compete with Australia Post. A number of postal service providers are already well placed to take advantage of the more competitive environment. According to Arthur Andersen:

Several potential competitors claim to have fairly substantial delivery networks, covering more than 90% of all households in Australia. It is conceivable that one or more of these companies will undertake to provide a full mail service, although some interconnection with Australia Post would appear inevitable in remote areas (Arthur Andersen 1998, p. 5).

The Council considers that increasing competition in the postal services market, by liberalising business mail, will remove the need for the existing legislated access arrangements for bulk mail interconnection. Further, in keeping with the spirit of the Competition Principles Agreement, the Council believes that access to Australia Post's network should be primarily on the basis of commercial negotiation. This is particularly so in those areas where it is economic to establish a postal network in competition with Australia Post.

Given the preference for access based on commercial negotiation the Council has considered whether any access provisions are needed.

Services provided by Australia Post as part of its CSO would be uneconomic in the absence of specific funding arrangements. Under the Council's reform package, funding the uneconomic services to CSO areas will be provided through the Federal budget or an industry levy. It is then appropriate that new postal service providers gain access to delivery services provided by the CSO leg of Australia Post's network.

As well, the post office box element of Australia Post's business will have strong monopoly characteristics in the initial years of market liberalisation, by virtue of:

- Australia Post's long-standing position as a monopoly provider of postal services;
- the inability of some customers to receive mail other than through a post office box;
- past Australia Post policy on location of, and accessibility to, post office boxes; and
- initial reluctance by businesses to change to post office boxes provided by competing postal service providers.

According to Ansett Australia, restricted access to post office boxes:

...is becoming an increasingly important issue as, increasingly, catalogue and magazine as well as direct mail address lists, include a substantial number of addressees using a Post Office box (Ansett Australia, submission 83, p. 4).

As a consequence, business customers with mail to go to post office boxes and rural/remote addresses will be unable to obtain a full service from competitors in a more competitive postal services market, unless competing providers can access them

through Australia Post. If a competitor is unable to access those parts of Australia Post's network, Australia Post's incumbent power will be consolidated. This could impede market entry, damage the existing level of competition and consequently limit the benefits available to consumers through competition.

It is therefore the Council's view that access arrangements be restricted to:

- areas where Australia Post provides a service only because of its CSO; and
- Australia Post's post office boxes.

The National Access Regime

Given the need for some access provisions the first step is to consider whether it is possible to rely on the national access regime established under Part IIIA of the Trade Practices Act, or whether separate access arrangements are necessary. Australia Post is currently exempt from Part IIIA, which deals with access to services provided through nationally significant infrastructure. Under Part IIIA, a person who wants access to a particular infrastructure service may apply to the National Competition Council to have the service 'declared'. The Council assesses the application against set criteria and if the service is declared, the business and infrastructure operator then are required to negotiate terms and conditions of access. If they fail to reach agreement, the terms and conditions are determined by the ACCC through legally binding arbitration. Part IIIA also allows owners of infrastructure to lodge access undertakings with the ACCC detailing the terms and conditions under which they will provide access to their facilities.

While the Council has not undertaken a full assessment of postal services against the declaration criteria it is likely that most existing postal services will not meet the tests for declaration under Part IIIA. Still, the Council sees no practical reason why Australia Post should be treated differently to other companies in Australia and why postal services should be exempt from the application of Part IIIA.

Recommendation

The Council recommends that Australia Post's exemption from Part IIIA of the Trade Practices Act should be repealed (Section 9.4.2, Volume Two).

Additional access provisions

Given that the declaration provisions of Part IIIA are unlikely to be used as an access regime for postal services, the Council believes that specific access arrangements for postal services may be required. In considering what access arrangements are appropriate as competitive safeguards, the Council has taken into account:

- the need to balance the objectives of increasing competition and promoting innovative postal services with adequately compensating Australia Post for the services it provides; and
- the practical issues and costs of implementing and administering any new access regime. This includes the impact it may have on incentives for Australia Post to invest in its network. At the same time, competitors must be encouraged to establish their own post office box facilities on competitive routes.

In considering the appropriate regulatory arrangements to support access to the CSO routes and post office boxes, the Council has opted for a ‘light handed’ approach. The reform package proposes that access to the CSO routes and post office boxes be supported through a compulsory access undertaking, following the requirements of Part IIIA of the TPA. An undertaking will impose limited regulatory cost on industry and regulators alike, given that once an undertaking is settled, both industry and regulators will be certain of the mandated access arrangements. By proposing an undertaking and having it accepted by the ACCC, Australia Post can remove uncertainty about what access conditions and prices will apply to the service. The undertaking would be legally binding, enabling other businesses to use it to gain access. Before accepting an undertaking the ACCC is obliged to conduct a public consultation process, canvassing issues such as the appropriate terms and conditions of access.

In order for access to be effective, it will be necessary for Australia Post to have an access undertaking for CSO and post office box services in place at the time of market liberalisation. If Australia Post does not submit an acceptable undertaking the ACCC would have the power to determine the terms and conditions of access. Should it be necessary for the ACCC to determine an access undertaking, this should occur within three months of market liberalisation.

These arrangements should be reviewed five years after the reform package is implemented.

Recommendation

The Council recommends that:

- **a compulsory undertaking, to be approved by the ACCC, be developed by Australia Post for CSO and post office box services; and**
- **if Australia Post does not submit an acceptable undertaking the ACCC should determine the terms and conditions of access (Section 9.4.2, Volume Two).**

Access pricing

One of the key issues for the ACCC in assessing the undertaking will be the pricing methodology used by Australia Post to determine the cost of providing access. The Council believes that these pricing issues should be resolved by the ACCC in consultation with the postal services industry. However, it has identified a number of pricing matters which it believes should be addressed in an access undertaking. These are discussed further in Chapter Nine, which makes the following points:

- The price of access should reflect the actual cost of providing the service. It should not be the average cost of providing similar services across the network.
- When assessing the cost of access it is legitimate to consider the returns on investment made by Australia Post.
- The access price should not exceed the retail or bulk prices for services akin to those included in the access undertaking.

Recommendation

The Council recommends that only the direct cost of providing access to CSO and post office box services should be taken into account in determining access prices. These costs would include consideration of Australia Post's return on assets (Section 9.4.1, Volume Two).

Part IV of the Trade Practices Act

The provisions set out in Part IV of the TPA seek to prevent anti-competitive practices by companies with market power and are enforced by the ACCC. While Part IV of the TPA will constitute an appropriate and adequate safeguard against anti-competitive conduct in a mature competitive postal services market, the Council believes this will not be sufficient in the newly deregulated postal industry.

During the initial years of deregulation the Council believes that additional competitive safeguards will be necessary to ensure that Australia Post's inherent market power is not used unfairly to impede competition. Australia Post's market power is derived from its incumbent advantages, which include an established universal network, specific structural arrangements involving joint ventures, customer inertia as well as a recognised brand name. While competition in the postal services market is at an immature stage, these provisions will be a necessary competitive safeguard to support the 'light handed' postal access regime discussed above. According to the Industry Commission:

Australia Post is the dominant provider of postal services in Australia. This is largely because its privileges and responsibilities under the Act both encourage and require it to maintain a broad network. In 1995-96 it handled over 4 billion mail items including letters and parcels but excluding unaddressed advertising (IC, submission 58, p. 6).

In a more competitive environment, it is conceivable that Australia Post could use that power unfairly in order to drive existing operators from the market and preclude other companies from entering the postal services market and operating on an equal basis.

A review of Australia Post's market power and, therefore, the need for these safeguards should be carried out five years after the reform package is implemented

Anti-competitive conduct provisions for postal services

To address the initial market power Australia Post will hold, the Council believes that a new sub-section should be created under section 46 of the TPA to deal with any potential anti-competitive conduct in the business mail segment of the postal services market. This new sub-section would, in contrast to section 46(1) of the TPA, place

the onus on a postal service provider to establish that it has not engaged in anti-competitive conduct, rather than the onus being placed on the ACCC or an affected party.

Once evidence is established that:

1. a postal service provider has a substantial degree of power in a postal services market; and
2. the effect of taking advantage of that power is a substantial reduction in competition;

the anti-competitive purpose of that conduct will be *presumed* under this new sub-section.

Specifically, the benefits of the introduction of such a provision for postal services include:

- requiring the ACCC to focus its regulatory oversight on the business letter segment of the postal services market;
- providing a stronger regulatory safeguard against anti-competitive behaviour than would otherwise exist in the initial years of deregulation; and
- allowing swifter and more vigorous action in respect of market conduct in an industry undergoing substantial change.

The question of whether a postal service provider has engaged in anti-competitive conduct would ultimately be determined by a court using the same tests as are currently applied under section 46. The primary difference is that the new sub-section would oblige a postal service provider to submit evidence that it has not engaged in anti-competitive conduct. As currently provided for under the TPA, the ACCC would be able to issue an authorisation, where appropriate, which would allow Australia Post to engage in conduct that would otherwise breach TPA provisions.

Recommendation

The Council recommends a new section of the TPA dealing specifically with anti-competitive conduct in the market for postal services. The need for this provision should be reviewed in 2005 (Section 9.5, Volume Two).

Structural Reform

The Terms of Reference for the review require the Council to have regard to the Government's obligations under the Competition Principles Agreement of April 1995, which address structural reform of public monopolies.

This commitment requires the Commonwealth, before introducing competition to a public monopoly, to separate out any regulatory role from the operation of the business and consider, among other things, the merits of changing the structure of the business and separating out those parts which have monopoly characteristics.

The Council, therefore, examined the merits of separating the competitive elements of Australia Post's business from the monopoly elements.

Problems in separating the costs of monopoly and competitive business activities

Many public monopolies have monopoly elements integrated with potentially competitive activities. The principles underlying the National Competition Policy suggest that where competition is to be introduced to a sector traditionally supplied by a public monopoly, structural separation of the monopoly elements from the competitive elements should be favoured.

The rationale for this principle is that structural separation, in a more liberalised market environment, will act as a safeguard against anti-competitive behaviour by the former monopoly, when removal of regulatory barriers alone will not deliver a competitive market. Some parties have raised concerns that the sharing of facilities by Australia Post raises competitive neutrality issues which can only be addressed by structural separation.

Anti-competitive cross-subsidisation can both deter potential competitors from entering the market and force out or severely disadvantage existing competitors. As a consequence, an incumbent's former monopoly status is likely to be maintained and the full benefits of a competitive market will not be delivered to consumers.

Australia Post has a clear mandate to use cross-subsidies to fund its CSO. However, questions have been raised about Australia Post's ability to use cross-subsidies outside the reserved services - in particular, whether Australia Post's prices in competitive markets are being cross-subsidised from reserved services revenues.

The difficulty with claims that Australia Post is cross-subsidising its services in competitive markets is verifying that it has priced its services unfairly below cost. The nature of Australia Post's business is that the extra costs of providing some services are very low because they can piggyback on the network and equipment which are already in place. In particular, if the services in question are 'one off' contracts, arguably it is Australia Post's short term costs which are pertinent and these are likely to be very low.

Some of the concerns of submitters to this review have arisen because it is hard to demonstrate that the sharing of facilities by Australia Post does not give rise to competitive neutrality issues. This is particularly so given the lack of transparency in how the costs of different parts of Australia Post's business are separated. Hence the preference by some submitters for structural separation of Australia Post's activities.

Structural separation not the preferred option

The Council acknowledges that there are risks to competition when a company is operating in both monopoly and competitive markets. The Council, however, believes that these risks are reduced when a former legislated monopoly, with relatively low barriers to entry, is opened to competition. Over time competition will neutralise the advantages of the former monopolist.

In addition, there are off-setting advantages in providing a range of services through the postal network. For example, the Council's consultation process clearly indicated there is strong support for the convenience of a one-stop-shop. Australia Post's retail outlets and the services available within those outlets are generally well received both in the metropolitan and regional centres. Stakeholders have indicated that being able to pay bills, purchase stationery, envelopes and stamps and mail letters and parcels at one location is clearly in the interests of customers.

Finally, there are clear economies of scale and scope associated with the operation of Australia Post's network. These economies should not be denied to Australia Post. Rather, other service providers should be allowed the opportunity to replicate them where possible.

The Council considers that, on balance, the structural separation of the natural monopoly and competitive elements of Australia Post's activities is not necessary or desirable.

Accounting separation and transparency

It is not clear whether the current accounting practices of Australia Post accurately allocate costs to each business unit. As a consequence, the costs of Australia Post providing its core business - the reserved service - and its competitive businesses - the non-reserved services - may be mixed and not appropriately attributed to particular services. As such, it is not possible to determine whether Australia Post is highly competitive in some services because:

- it could be cross-subsidising its competitive activities by using profits from its reserved services by loading its costs onto the reserved services areas; or
- it could be competing effectively simply because it can take advantage of the legitimate cost savings it can generate by providing a number of services through its network.

Without transparency in Australia Post's accounts this debate will not be resolved.

While the Council considers that structural separation is not warranted, there is a need for reliable accounting separation to support a number of components of the Council's reform package to:

- address competitive neutrality issues, including those affecting the retail network;
- facilitate effective access arrangements;
- provide the ACCC with the information it needs to investigate misuse of market power; and
- cost CSOs accurately.

The separate accounts need to cover the following areas:

- reserved and non-reserved services;
- Community Service Obligations; and
- the Retail Network

Accounting separation also needs to include clear information as to how common costs are allocated and the reasons why they are allocated to the various business units. This information will assist the Government and regulator in determining whether the costs have been properly allocated.

Recommendation

The Council recommends a requirement for detailed auditing and accounting information on Australia Post’s activities, to provide for transparency of the financial relationships between different elements of the business (Section 9.5, Volume Two).

Price Regulation

In a monopoly, the incumbent has the opportunity to charge higher prices than would be possible in a competitive market. This means that any efficiencies gained are not passed onto the consumer in the form of lower prices and/or better quality services. Price regulation is a means of addressing these issues.

Australia Post’s reserved services - its monopoly - currently are subject to prices surveillance under the *Prices Surveillance Act 1983*. Prices oversight is undertaken by the ACCC and the Minister for Communications and the Arts. The price of standard letters must be approved by the Minister and proposals to increase prices or change terms and conditions of the reserved services must be notified in advance to the ACCC.

Australia Post has argued that it:

... (does not) see any justification for the application of any pricing regulation, monitoring or oversighting for goods or services which are not reserved to Australia Post, unless this also applied to competitors so as to preserve competitive neutrality (Australia Post, submission 99, p. 89).

The MMUA largely supports this view but notes that where there is a supplier with a dominant market position:

... there should be a form of price control, or price justification, simply because the Australian market place has no valid alternative service, notwithstanding the legal niceties which might suggest that alternatives can be provided (MMUA, submission 33, p. 20).

The Competition Principles Agreement envisages that all significant Government Business Enterprises that are monopoly, or near monopoly, suppliers of goods or services should be subject to independent prices oversight. According to the Industry Commission:

Prices surveillance is not likely to be needed if the reserved service is abolished. However, a less intrusive form of prices oversight, such as prices monitoring, should be applied temporarily. Under prices monitoring, Australia Post would only be required to provide certain price and cost data at regular intervals to the ACCC. This requirement would only need to be imposed on services where there is particular doubt about the significance of barriers to entry or until such time as competition fully develops (IC, submission 58, p. 33).

The Council considers that future regulation of Australia Post's charges should be dependent on the bounds of Australia Post's narrowed letter service reservation. The barriers to entering the postal services market are not high. Therefore, the Council considers that direct oversight and regulation of charges for non-reserved services is unwarranted. Initially, there would be value in monitoring the newly deregulated services to assess whether prices are too high or too low given Australia Post's position in the market.

Recommendation

The Council recommends that the reserved services be subject to the same method of prices surveillance as currently applies. That is, proposals to change prices or terms and conditions for reserved services should continue to be notified in advance to the ACCC and the price should continue to be subject to approval by the Minister.

The ACCC should undertake regular prices monitoring of non-reserved services for the first five years of deregulation. The need for this provision should be reviewed in 2005 (Section 9.6, Volume Two).

Competitive neutrality

As has been discussed previously, Australia Post provides many services in competition with other businesses. For instance, it faces significant competition in the sale of books (competition mainly from book stores and newsagents) and stationery (office product retailers and newsagents), the delivery of parcel post, express post and international post (couriers such as TNT and Mayne Nickless) and the provision of electronic services (banks and communications service providers).

Competitive neutrality is about introducing those changes needed to ensure that significant government businesses do not have any advantages or disadvantages compared to the private sector simply because of their government ownership. This will mean that they will be on an equal footing when competing with private businesses.

Competitive neutrality complaints mechanism

Towards this end it is important that a mechanism for dealing with competitive neutrality complaints be established by all jurisdictions, including the Commonwealth, to ensure there is a forum to which private parties can direct competitive neutrality issues of concern.

A bill to establish the mechanism for handling competitive neutrality complaints has been drafted by the Government but has yet to be passed by Parliament. Until the bill is passed, however, there is no forum to take up people's competitive neutrality complaints concerning Commonwealth owned businesses.

Recommendation

The Council recommends that the mechanism for handling competitive neutrality complaints that arise in relation to businesses owned by the Commonwealth Government be formalised as soon as possible (Section 10.2.1, Volume Two).

Achieving competitive neutrality

A number of submissions from newsagents suggested they are disadvantaged because Australia Post can compete in stationery retail but newsagents are not allowed to sell stamps on commission. According to the Federal Member for Warringah, Mr Tony Abbott:

Australia Post's monopoly over the sale of stamps does give it an unfair advantage and privileged access to a customer base in competition with small private businesses (Tony Abbott MP, submission 53, p.1).

The Council considered the possibility of explicitly requiring Australia Post to allow businesses to sell stamps on commission. In weighing the benefits of increased access to stamps against the commercial norm by which a company can choose the way it distributes its products, the Council considers that it is more appropriate that the availability of stamps be addressed through USO requirements and that additional restrictions should not be imposed on Australia Post's ability to decide how to best sell its services.

The Council notes that newsagents and other competitors to Australia Post are not constrained from purchasing 45 cents stamps at face value for on-selling to their customers.

The Act and Australia Post

Australia Post has established and consolidated its extensive network through decades of holding a legislated monopoly in the letter segment of the postal industry. Therefore, it was necessary for the Council to look at whether there are any other specific advantages or disadvantages Australia Post enjoys under its legislation.

A detailed analysis of the relevant provisions is set out in Chapter Ten of Volume Two. The Council finds little justification for maintaining those provisions which advantage or disadvantage Australia Post compared with its competitors. In a number of instances, the provisions provide no benefits and the Council can find no justification in recommending they be retained.

The Commonwealth Government is restructuring its relationship with all of its business enterprises. As part of this restructure, the relationship between Australia Post and

the Government will be changed to that of business to shareholder with the Board of Australia Post being answerable to two shareholder Ministers. The Council, therefore, considers that some of the provisions in the Act, which give the Minister the power to direct the commercial activities of Australia Post, should be removed or amended. This would enable Australia Post to run its business in a manner consistent with the approach for other business enterprises under the new regime.

The Council considers it important that government ownership of Australia Post does not result in Australia Post's freedom to act commercially being impeded in any way.

In the case of privacy arrangements and the obligation to notify customers in the event an article is opened, the Council recommends that these obligations apply to all participants in the postal industry.

Recommendations

The Council recommends that the following sections of the Australian Postal Corporation Act be removed:

- **section 32 which gives Australia Post the right to impose its own terms and conditions upon which its service can be supplied;**
- **section 34 which exempts Australia Post from liability for any loss or damage suffered due to an act or omission by Australia Post;**
- **section 46 which gives the Minister the power to influence whether Australia Post undertakes significant business activities;**
- **section 90B which prohibits any State or Territory law from discriminating against Australia Post; and**
- **section 90D which restricts the application of State and Territory building and construction laws to Australia Post prior to 1 January 1991;**

and that the following be amended as specified:

- **section 48, which requires Australia Post to comply with general policies of the Commonwealth Government if**

notified to do so by the Minister; to ensure that the Minister must first table the applicable general policies in Parliament;

that the following sections be extended to cover all postal operators:

- **section 90V so that all participants are required to place notification on an article that has been opened for any purpose or reason;**
- **Division 2, Part 7B so that all participants be required to comply with general privacy requirements; and**
- **section 101 which grants title to all postal articles to Australia Post for the purpose of any legal proceeding and that the property rights of customers be clarified (Section 10.4.1, Volume Two).**

Other Acts and Australia Post

The Council was advised of some provisions in other legislation that confer a benefit on Australia Post. For example, the Department of Transport in Tasmania has advised the Council that Australia Post contractors must have a cart licence to operate. However, the Tasmanian Traffic (Public Vehicles) Regulations 1967 provides that a vehicle owned and operated by Australia Post, for the purpose of mail or courier item deliveries, does not require a public vehicle licence provided it does not carry any item weighing more than 30 kilograms. This is in contrast to its competitors, which must obtain a public vehicle licence to provide mail or courier deliveries. The Council notes that Tasmania is due to review the relevant legislation shortly and suggests that this issue be addressed in its review.

Recommendation

The Council recommends that if there are any taxes, rates and charges remaining to which Australia Post is not currently subject, these should be imposed on Australia Post without delay in accordance the Competition Principles Agreement (Section 10.5, Volume Two).

Other submissions advised of a disparity in the imposition of customs duties. Under the *Customs Act* 1901 (Cwlth), import consignments of less than \$1000 in value, arriving through Australia Post, are excluded from the formal Customs import entry obligation. In contrast, imports consigned other than by Australia Post are excluded from this obligation only if the value is less than \$250. Similar differences apply to goods being exported via Australia Post as opposed to other operators.

Recommendation

The Council recommends that the Customs Act be amended promptly to ensure that all postal operators are subject to a threshold to the same value (Section 10.5, Volume Two).

Finally, the Council was advised of exemptions in State and Territory road traffic and safety legislation and regulations which give Australia Post employees and contractors the right to ride their motorcycles on footpaths for the purpose of delivering postal articles door-to-door.

The National Road Transport Commission (NRTC) has advised the Council that it is aware that this issue needs to be addressed for National Competition Policy purposes. The NRTC intends to seek to have the relevant legislation and regulations amended so that exemptions can apply to any person who is authorised to deliver postal articles provided they satisfy any relevant criteria. The Council notes that States and Territories will be reviewing the relevant legislation granting Australia Post privileges in relation to the operation of motorcycles on footpaths over the next two years.

Recommendation

The Council recommends that any provisions which grant Australia Post employees and contractors an exclusive right to operate motorcycles on footpaths be amended to ensure other postal deliverers can obtain similar exemptions when required (Section 10.4.2, Volume Two).

9. Impact of Reform

In recommending reform, it is necessary to understand its effects on all sectors of the community. In formulating its recommendations, the Council has been mindful of the experience of reform in other countries, as well as considering the views of the Australian postal industry and the consultancy it commissioned for this review.

Effects of Competition

Customers

Individual customers and households

For some categories of customers, particularly small volume mailers, including individuals and households, the effects of the Council's reform package will be barely noticeable. Australia Post will still charge a uniform rate of postage and the universal service will still be available. In submissions, it was usually these groups which suggested that the current policies should not change. By retaining the monopoly for these customers the Council's recommendations will ensure their interests are protected.

These customers will also still have access to a complaints mechanism, through the office of the Commonwealth Ombudsman and a greater guarantee of the quality of the universal service through Australia Post's service charter and the regulations which support it. In addition, the industry code of conduct will ensure that services such as mail holding and mail redirection are still available, no matter who delivers the mail.

Large volume customers

Large volume users and mailing houses have argued that there would be significant gains from competition. The Council's recommendation to increase competition for business mail will have a number of effects. Business customers should encounter greater choice of both product and supplier, increased flexibility, lower prices, the ability to negotiate terms and conditions that meet their requirements, and special products and services. As TNT has noted:

Opening the above markets to competition would result in an immediate expansion in the range of service offerings, allowing customers a choice of collection options including on site pick

up, a range of delivery times and service frequencies, and various priority, tracking and security options at differentiated competitive prices. (TNT, submission 87, p. 7).

Streetfile has noted that the restrictions on competition have, among other things:

... imposed indirect taxes on business and urban consumers;... prevented mail from taking its rightful place as the low cost alternative for direct consumer marketing, thereby adding to consumer costs;... prevented the transfer to Australia of expertise, skill and technology needed to resolve distance communications problems for Australia's rural and remote communities ... (Streetfile, submission 10, p. 31).

For example, Streetfile claims that the price of the letter rate for large volume mailers could fall by as much as 20 percent if the postal services market was opened up.

The most obvious change for large volume customers is that competitors will be trying to attract their business. Therefore, all service providers will be trying to offer the most flexible package of services to suit each customer's specific needs.

The Council has recommended that the universal service obligation still apply to business mail. Therefore, the coverage of the network, which is also important to many large mailers, is guaranteed.

Small business customers

Small business will have a choice of using the 45 cent uniform rate letter service, an alternative postal provider or a discounted service through Australia Post.

Several submissions noted that there are a number of organisations, including small businesses, which do not generate sufficient mail to take advantage of Australia Post's bulk mail discounts and which could benefit from a more competitive regime.

Small business in particular would benefit from the opportunity to have service and price packages tailored to their individual requirements (TNT, submission 87, p. 7).

However, with competition, there are strong incentives for Australia Post to attract the maximum business it can. Therefore, it is likely that greater discounts than currently offered will be available to small business.

Some submissions have suggested that there may be advantages to be gained for small businesses if mail consolidation is permitted. At present, a minimum mailing of 1000 letters is required to qualify for a bulk discount.⁴ Maximum discounts are available if the mail is sorted to postcode level. To gain these largest discounts the volume of mail generally needs to be quite high. Because of the magnitude of the required volumes, most small business mail would not qualify for bulk mail discounts. More mail could be sorted to the postcode if mail from more than one job was combined by the mailing house processing the mail. Such consolidation of mail from multiple jobs is currently not permitted by Australia Post.

One mail house noted:

... we need to be able to aggregate mail of similar classification across multiple clients. This provides the advantage to smaller bulk mail customers to gain access to higher levels of presort discount (Salmat, submission 118, p.13).

The Council's proposal allows Australia Post to choose whether or not it will accept aggregated mail. It also provides strong incentives for Australia Post to maximise its volume and minimise its costs. If aggregation reduces Australia Post's costs of sorting and barcoding small business mail and provides savings for customers (thus encouraging them to use Australia Post's services) then one would expect there to be more aggregation of mail than currently takes place.

The benefit to small business is that they will still have access to the guaranteed prices and services available to the household sector but they will also have the option of seeking alternative services if they wish.

Remote Area Customers

As with individuals and households, the effect of the Council's reform package on rural and remote customers will be minimal. Customers will still have access to the uniform rate of postage and industry codes of practice will mean that the mechanisms for dealing with mail redirection and return mail will remain.

⁴ The minimum lodgement is 1000 letters if delivery is to a single post code and 2500 if delivery is to more than one post code.

However, rural and remote customers will be given greater certainty in their CSOs. Not only will the CSO be better defined, but customers will know what to expect from the CSO. The delivery of CSOs will be monitored and the results made public.

The funding for CSOs will be based on the services outlined in Australia Post's Service Charter. Even where competitors decide to provide a limited service, Australia Post will still be funded to provide the CSO at the agreed standards. This will ensure the maximum benefits from competition while guaranteeing the availability of affordable services.

The Council has made several recommendations designed to address problems specific to the bush. They include: changing Australia Post's approach to community polling; abolishing the fees on private and locked bags for those receiving less than three deliveries a week; and remuneration for the work done by communities to distribute mail received in a community bag.

Competitors

Competitors to Australia Post are likely to fall into two categories: those supplying the full letter service (although not necessarily with universal coverage) and those supplying part of the letter service, such as mail houses. The targets for both groups, at least in the short to medium term, will be those businesses generating large numbers of letters.

It is not possible to predict precisely the type or number of competitors which will arise, or the range of services they will provide.

Any competitor will need to offer an attractive package in order to overcome the incumbent benefits Australia Post will retain. In particular, Australia Post has strong customer loyalty and a very positive customer image. For a large number of postal service users, the cost of the postage is only a small part of their budget, so incentives to switch suppliers will need to be very strong.

Competing delivery networks are most likely to emerge where populations are dense, mail volumes are high and a range of services can be provided to gain the advantages of economies of scale and scope. The Council considers that two types of networks are most likely to arise and these would focus on large volume customers. These networks would be:

- a national network linking metropolitan and major regional cities, but with no rural or remote coverage; and
- a number of local networks, serving metropolitan or regional centres.

Several organisations have indicated they may consider setting up a national network. Indeed, Streetfile has noted that its coverage is already very wide.

Streetfile is already an alternative postal network. We operate the largest private sector addressed delivery network in Australia, delivering to 96 per cent of Australian households (5.85 million) through a network of 24,168 contractors offering seven days a week, 365 days a year deliveries (Streetfile, submission 10, p. 38).

In other countries where the postal service has been opened to competition, new service providers have also targeted local area delivery. This has occurred in both Sweden and Finland. In Australia, if companies wish to provide this kind of service at present, they must do so as couriers.

The first [matter] is Australia Post's monopoly over intra-town mail. It is our understanding that alternative deliverers of mail within the town of Narrogin must assume courier status if they are to undertake the work. Further, that courier status brings with it a high degree of regulation and control that simply make it uneconomic to compete with Australia Post (Town of Narrogin, submission 48, p.1).

Reform will also allow competitors to offer a wider range of services than at present. While some of these services and products may bear a strong resemblance to Australia Post products, there will be scope for niche products, particularly at the local level, and products tailored to customers' needs. It is likely that competitors will face considerable competition from Australia Post as it seeks to protect its market while at the same time expanding its product lines to counter the emerging competitive pressures.

As Australia Post provides only one type and level of service for its reserved services, consumers have no choice in the level of service.⁵ TNT has argued that it is not

⁵ Mailers who are able to post in sufficient bulk to take advantage of the bulk pre-sort discounts are able to choose a lower level of service and pay less by choosing the "Off Peak" option.

possible to know exactly what consumers would demand, and what suppliers could provide in a deregulated market:

The experience with telecommunications and other utilities demonstrates that competition will lead to an improved array of services, a choice of packages tailored to customers' service requirements and usage patterns, and a greater customer focus. Only a competitive environment allows a meaningful answer to whether the current postal arrangements are satisfactorily meeting the community's needs. Certainly we know that where other utility services have been opened to competition, the consumer has responded positively to the increased choice and the market has grown. There is little doubt that consumers would like to see more flexibility in opening hours, have access to weekend deliveries and be able to choose between a greater variety of appropriately priced services. (TNT, submission 43, p. 10)

Several other submissions have also noted the effects of freer competition following the reform of the telecommunications market.

Increased competition (eg telecommunications) in other markets has seen dramatic improvements in the quality, price and range of services available. A relaxation of the competitive restrictions that saw similar developments in the postal sector would be desirable (Insurance Council of Australia Ltd, submission 134, p.5).

The Council's reform package will also allow for competitors to access the private post boxes supplied by Australia Post as well as the CSO services. This will have particular importance for competitors for whom breadth of coverage is important. More broadly, the recommended changes to the anti-competitive conduct provisions of the Trade Practices Act will act to address the initial incumbent advantages expected to be enjoyed by Australia Post for the first few years of competition. Further, the accounting separation requirements will provide the information needed to investigate complaints about access, Australia Post's market behaviour and competitive neutrality.

All competitors will be licensed and will need to meet an industry code of practice which will guarantee that those aspects of customer service which require co-operation among service providers - for example, return-to-sender and redirected mail - will be addressed.

Australia Post

Australia Post will continue to be a viable business after deregulation, making a significant contribution to the postal industry and the economy. It will still provide the only universal postal network and be fully funded for the CSOs which result.

Under the Council's reform package, Australia Post will face greater competition which will focus on business mail and particularly bulk business mail. But it will also be given the freedom to respond to that competition. Australia Post will be free to negotiate discounts for business customers and offer service packages which meet their needs.

Compared with the regulation which accompanied the deregulation of telecommunications, for example, the Council's recommendations are light-handed. They include access provisions for post office boxes and CSO-funded services, accounting separation and provisions to address market power.

In developing its reform package, the Council has considered three key areas of concern about the impact of competition on Australia Post:

- whether Australia Post's reform proposal is the best possible model;
- the potential for 'cream skimming'; and
- the impact on Australia Post's profitability.

These issues are now discussed in turn.

First, Australia Post proposed a package of reforms that involved:

- phased reduction of the reserved services protection to one times the uniform postage rate;
- a halving of the weight limit to 125 grams by 2001; and
- a review of arrangements in 2003.

The package also included the retention of current prohibitions on letter aggregation, existing access arrangements, new discounts on barcoded mail, retention of the 45 cent uniform letter rate until 2002 and a charter of postal responsibilities. Australia Post argued that this package constituted the outer limit of reform possible without compromising the viability of its business and/or the standards of the universal letter service.

The Council considers that Australia Post has underestimated the level of reform its business can tolerate, just as it did in relation to the 1994 reforms. In 1993, Australia Post estimated that the 1994 changes would put at risk \$250 million of revenue. The actual loss of growth was only seven percent of this original estimate. Australia Post has already demonstrated its ability to flourish in competitive markets. Two thirds of its profit is generated from services open to full competition.

While the reform package proposed by the Council looks very different to Australia Post's package, in gross terms the Council's package exposes only slightly more revenue to competition. The 1994 amendments deregulated letter services which, at the time, accounted for around ten percent of Australia Post's annual revenues. Currently, about fifty percent of Australia Post's revenue is earned from services in competitive markets. Under Australia Post's proposal, this would increase to 84 percent. This compares with the Council's package where the revenue exposed to competition would be 93 percent, albeit increased to this level over a shorter time-frame. The main difference lies in the deliberate targeting by the Council of deregulation of services where competition would provide the greatest benefits to the community and the least threat to the universal service obligation.

Second, in contemplating the question of market entry, it is important to note that competitors will be able to make a profit in three circumstances:

- 'cream skimming' (see Box below);
- providing new types of services; and
- offering existing services at lower prices.

The last two reasons are highly desirable, as the result is services which better meet the needs of customers at a lower cost. However, arguments have been raised with the Council that reducing the reserved services will reduce Australia Post's ability to fund the CSO because of 'cream skimming' by other service providers.

The potential for 'cream skimming' arises when Australia Post faces restrictions on its ability to price services down to cost. There are currently two types of these restrictions which affect Australia Post. First, the funding of the CSOs through a cross-subsidy. Second, the uniform rate of postage.

Under the Council's recommendations Australia Post is protected from both of these potential areas of cream skimming. On the first, the Council has recommended alternative ways of funding the CSOs. On the second, the Council is recommending retaining a monopoly over the services covered by the uniform rate of postage and

Cream skimming

The standard (45 cent) letter service does not make a loss on all routes. On most routes, in particular intra-city mail paths, it makes a profit. However, on some routes, such as between remote locations in different states, 45 cents does not cover the costs of delivery. Australia Post uses the revenue from its profitable routes to cover its costs on the loss-making routes.

If Australia Post did not have the protection of legislation, other operators might seek to service the very profitable mail paths by undercutting Australia Post. They might be able to do so because Australia Post has a higher average cost over its entire network because of its need to service the loss-making mail paths.

The strategy of servicing only the highly profitable mail paths while ignoring loss-making mail paths is sometimes called ‘cream-skimming’ or ‘cherry picking’.

therefore competitors are prohibited from competing in these services unless they charge at least double the uniform rate. In the competitive segment of the market, Australia Post will be free to discount its prices to meet its competition.

Finally, it has been suggested that increasing competition will reduce Australia Post’s profitability well below acceptable levels. Over the past three years, Australia Post has been a very profitable business; in fact, more profitable than similar businesses operating in competitive markets. Australia Post operates a relatively low risk, network business. Yet, over this period, its return on assets has been high compared to all companies listed on the stock exchange, higher than any public company in the transport industry and equal to the best performing public company in the retail sector. Consultant work to this review by Arthur Andersen suggests that even with:

- full deregulation of letter services;
- no increase in prices;
- retention of the USO without compensation;
- no additional cost-cutting, productivity or marketing measures; and
- the retention of existing capital expenditure plans.

Australia Post would continue to earn at or around a commercial rate of return on assets for its type of business until at least 2005.

Arthur Andersen Consultancy

The Council commissioned Arthur Andersen to undertake a study of the effects on Australia Post's financial outcomes of reductions in the threshold monopoly letter rate. Arthur Andersen was asked to report on the effects on Australia Post of reducing the threshold to three, two and one times the standard letter rate, as well fully removing the reserved services protection. In developing its model, Arthur Andersen assessed the level of competition likely at each reduction in the price threshold, as well as its effects on the market and Australia Post's position in that market.

However, Arthur Andersen notes that its model results are sensitive to the assumptions used. For example, if competitors were more aggressive in seeking market share, if growth in mail volumes is significantly less than the projected four percent and so on, Australia Post's financial position could be worse than predicted.

On the other hand, the model does not take into account any possible reactions by Australia Post to improve its financial performance in the face of greater competitive pressures. The Arthur Andersen model is based on assumptions which lead to very conservative results. In other words, the risk of the model outcomes understating Australia Post's robustness in the face of increasing competition are low, while the potential for Australia Post to exceed the results is higher. For instance, there are a number of factors which could increase Australia Post's profitability beyond the results predicted by Arthur Andersen:

- reducing operating costs or improving efficiency;
- deferring investment or identifying investment savings;
- external funding of the CSOs;
- growth in mail volumes resulting from lower prices or new services offered in a more competitive environment; and
- strategic plans whereby Australia Post reassesses its way of doing business in order to counter the impact of competition and reverse the erosion of its margins.

The Government

Another outcome from the Arthur Andersen modelling is that as increased competition will impact on Australia Post's profitability, so too will it impact on the size of the dividend paid by Australia Post to the Government. Arthur Andersen predicts that by 2005, the dividend to Government would be around \$150 million in the open competition case, or about half what it would be under the base case model. But the return on equity predicted by the Arthur Andersen model even under open competition is still more than 50 percent higher than the stock exchange average between 1992 and 1995. The Council considers that the Arthur Andersen estimates are conservative and it is likely that the fall in the return to Government will be less dramatic than the model indicates.

While there is likely to be a fall in the Government's revenues from dividends, there will be increased revenue from taxes collected from other service providers.

In addition, all levels of government are large customers of Australia Post. The mail generated by government departments, agencies and businesses and elected members would be typical of the type of mail which would be attractive to competitors of Australia Post. Therefore, one would expect the government to benefit from lower postage prices.

Employment

In a more competitive market, one of Australia Post's main aims will be to maintain its market share. To the extent that Australia Post is successful in achieving this, the reform package should not significantly affect employment at Australia Post.

If Australia Post was successful in expanding the appeal of its core services, the resulting increase in mail volumes will continue to provide employment opportunities for staff (Mayne Nickless, submission 120, p.21).

Based on recent history and the evidence provided to the Council, postal industry activity is likely to increase with less regulation and more competition. As prices fall, volumes can be expected to rise and this creates opportunities for new entrants as well as incumbents. Further, market freedom will increase which should offer new incentives for innovation and hence further market growth.

As such, increased growth in the postal services market will lead to growth in investment and, due to the labour intensive nature of the business, employment opportunities can be expected to rise in the medium to longer term.

Streetfile expects to approach a de regulated market with substantial capital investment. Others might be expected to do the same (Streetfile, submission 10, p. 32).

While some of this employment may be in delivery, other related areas of employment are also likely to increase, such as sales and marketing. For example, direct marketing would be expected to expand in a more competitive environment, with consequent employment effects. Reader's Digest has stated:

Direct marketing has created new supporting industries.....The ripple effect on employment is incalculable, but substantial since it spreads into organisations which use and rely on direct marketing such as banks, insurance firms, airlines, publishers, etc (Reader's Digest, submission 56, p. 3).

Since 1994 there has been limited deregulation of postal services. Total employment generated by Australia Post, Licensed Post Offices and Contractors has increased slightly and employment in the industry also has grown. Over the past two years there has been a 15 percent increase in employment in the postal and courier services sector (Australian Bureau of Statistics, Labour Force Estimates). Even in a totally deregulated market, postal services will remain relatively labour intensive, and total employment is likely to be strongly influenced by the level of services provided and overall industry activity.

The retention of the infrastructure necessary to service the rural and remote CSO will ensure that any reduction in regional employment levels will be negligible.

The CEPU has suggested that

Many competitors do not provide comparable employment to Australia Post, its workforce being essentially casual, untrained, under-paid and with little incentive for commitment to standards, Employment growth in such areas cannot compensate the Australian community on a one-for-one basis for the loss of full-time, award covered and skilled employment at Australia Post (CEPU, submission 127, p.49).

Australia Post also has suggested that growth is likely to be mostly in areas with low paid and casual or temporary employment (Australia Post, submission 99, p. 31).

However, in order to compete with Australia Post, the level of delivery guarantee and service that competitors offer may need to match or exceed that of Australia Post. Those wishing to compete against Australia Post will need employment and industrial relations strategies which will ensure that their employees can provide this level of service. It is likely that the CEPU and Australia Post are overly pessimistic.

In any case, the Council is wary of arguments about what may, or may not, be high quality jobs - particularly when the argument supports fewer jobs overall at a time of high unemployment. The Council considers that a company's costs are not automatically lowered by employing casual, untrained people on low pay. What is important is the skills employees have and the quality of their work, that is their productivity. In a competitive market, the more productive jobs will expand, while the less productive ones will contract. If the CEPU argument is that Australia Post jobs will be more productive than jobs in competing companies then the number of people employed by Australia Post will not fall.

Licensed Post Offices

The Council's recommendations only affect competition in business mail. That is, the recommendations will have very little affect on the retail market and will not affect any of the other services provided by LPOs. These sources of LPO income, therefore, will not change. Thus, the impact of the recommendations on LPOs should be minimal.

The volumes of letters delivered by LPOs will only fall if Australia Post's volumes fall. This is unlikely. The postal services market is growing so that even if Australia Post's share falls it is unlikely to be sufficient to result in a fall in actual volumes.

The income to LPOs from collecting mail will only be affected if competitors attract a large number of small businesses.

In addition, the maintenance of the USO and CSO services means that the business activities of LPOs in remote areas will be largely unchanged. Access to the post office boxes and CSO service could actually increase the revenue earned by LPOs as more competitors pay to use these services.

Timing

As can be observed from the preceding discussion, Australia Post's position is very strong both financially and in its position in the postal industry market. The Council, therefore, believes that Australia Post already is well placed to take advantage of, and benefit from, a more competitive environment. Indeed Australia Post itself also recognises the need to expand competition in the postal industry within the next three to five years. Under Australia Post's proposed reform, a significant proportion of its business would be exposed to competition by 2001. Australia Post acknowledged, under its proposal, the need for a further review in 2003.

Accordingly, the Council does not consider it necessary to have a transitional period between the present regime and the full implementation of the Council's reform package. This is because Australia Post already is well placed in the market and because the process of implementing the reform package will in itself delay the effects of reform.

First, the Government will need to deliberate the package and its implications.

Second, once the decision is made to implement the reform package, it will be necessary for the Government to draft the appropriate legislation and for that legislation to pass through both Houses of Parliament. The Council believes that competition should be introduced no later than 1 January 2000.

Third, once the necessary changes are introduced and the market is deregulated, it is likely that competitors to Australia Post will take time to adjust to the new regime, to tackle the new opportunities and to build market share.

Because of these delays, the Council considers that it will be after the year 2000 before the full effects of its recommendations will emerge. These delays will give Australia Post sufficient time to prepare itself for competition and time to allow competitors to position themselves in the market.

The Competition Principles Agreement requires that any remaining restrictions on competition be reviewed in ten years. Prior to this the Council has also recommended that a number of components of its package be reviewed five years after the introduction of competition, that is in 2005. These components are:

- the need for a maximum affordable charge to replace the uniform rate of postage;

- the continuation of resale price maintenance;
- the desirability of contracting out CSOs;
- the need for specific anti-competitive conduct provisions under the *Trade Practices Act*;
- the coverage and terms and conditions for access to CSO services and post office boxes;
- the need for Australia Post to continue to be Australia's official postal administration to the UPU; and
- the need for the ACCC to continue undertaking prices monitoring of non-reserved services.

Appendix One: Submissions and meetings

Submissions

The Council has received submissions from the following organisations and individuals:

1. Kingsgrove Cards and Stationery
2. Kevin Coogan
3. Dorothy Ross
4. Dr Kunwar Raj Singh
5. Isolated Children's Parents' Association of Australia (Inc.)
(Federal Council)
6. Commonwealth Services Delivery Agency
7. ACROD Limited
8. Australia Post
9. AUSDOC Group Limited
10. Streetfile
11. Shire of Wongan-Ballidu
12. Post Office Agents Association Limited
13. withdrawn
14. Mayne Nickless Limited
15. Queensland Commercial Independent Stationers
16. Communications Electrical Plumbing Union
17. Isolation Children's Parents' Association (Northern Territory)
18. Shire of Jerramungup
19. KEEP Australia Post PUBLIC
20. Country Women's Association of Victoria, Inc.
21. Australian Council of National Trusts
22. Shire of Katanning
23. Public Interest Advocacy Centre
24. Pastoralists & Graziers Association of Western Australia (Inc)
25. Gingin Shire
26. Bulloo Shire Council
27. Shire of Moora
28. Eastern and Central Regional Development Organisation
29. Australian Local Government Association

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30. Shire of Kojonup
 31. NSW Farmers' Association
 32. Regional Financial Services Taskforce - Ministry of Fair Trading (Western Australia)
 33. Major Mail Users of Australia Limited
 34. Town of Albany
 35. R Crocker
 36. Shire of Kellerberrin
 37. Merbein Parish Council
 38. Redlynch Village News Pty Ltd
 39. National Farmers' Federation
 40. M Murray
 41. Dunhill Madden Butler
 42. George Thompson
 43. TNT Australia Pty Limited
 44. Outback Regional Development Organisation Inc.
 45. Australian Chamber of Commerce and Industry
 46. Bungalow Postal Agency
 47. Local Government and Shires Associations of NSW
 48. Town of Narrogin
 49. Augathella Licensed Post Office
 50. Michael J Elijah
 51. Noel J Dundas
 52. The Treasury, Commonwealth
 53. Tony Abbott M.P., Federal Member for Warringah
 54. Kinglake Licensed Post Office
 55. Australian Heritage Commission
 56. Reader's Digest (Australia) Pty Limited
 57. Edmonton Licensed Post Office
 58. Industry Commission
 59. Shire of Carnamah
 60. Shire of Gnowangerup
 61. John Bradshaw, MLA, Member for Murray - Western Australia
 62. Shire of Ravensthorpe
 63. Shire of Mount Magnet
 64. Cotton Tree Licensed Post Office
 65. JAMK Pty Ltd
 66. J R Fenner
 67. Shire of Dardanup

68. Mukinbudin Shire Council
69. Red Hill Licensed Post Office
70. Yungaburra Licensed Post Office
71. Inverell Shire Council
72. Thargomindah Licensed Post Office
73. Shire of Victoria Plains
74. King Island Council
75. Plenty Food Store
76. Strathfieldsaye Licensed Post Office
77. Batlow Licensed Post Office
78. Australian Philatelic Federation
79. Western Australian Municipal Association
80. Crookwell Shire Council
81. Bland Shire Council
82. Campbells Creek Licensed Post Office
83. Ansett Australia
84. Post Office Agents Association Limited
85. Australian Chamber of Commerce and Industry
86. Bungalow Postal Agency
87. TNT Limited
88. Licensed Post Officers of Australia Ltd
89. CAPEC Pty Limited
90. Queensland Commercial Independent Stationers
91. Sunbury Office Supplies
92. Duaringa Licensed Post Office
93. Isolated Children's Parents' Association of Australia
(Inc.) (Federal Council)
94. Cowra Shire Council
95. Mid West Development Commission
96. The Country Women's Association of Western Australia (Inc.)
97. Small Business Development Corporation
98. Elizabeth McLeod
99. Australia Post
100. Shire of Wyndham- East Kimberley
101. Oxley Licensed Post Office
102. Combined Pensioners and Superannuants Association
of New South Wales Inc
103. North Bendigo Licensed Post Office
104. California Gully Licensed Post Office

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105. Bendigo Area Licensed Post Offices Group
 106. Matthew J Green
 107. Jonathan H Sive
 108. Strathdale Licensed Post Office
 109. Australian Newsagents' Federation Ltd
 110. Department of Education Training and Employment, South Australia
 111. Fish Creek Licensed Post Office
 112. Geoff Prosser M.P., Federal Member for Forrest
 113. Biggenden Licensed Post Office
 114. Newstead Licensed Post Office
 115. R A Bull
 116. Reader's Digest (Australia) Pty Limited
 117. Balanced State Development Groups
 118. SALMAT
 119. Catholic Women's League, New South Wales
 120. Mayne Nickless Limited
 121. Major Mail Users of Australia Limited
 122. Trinity Beach Licensed Post Office
 123. Plenty Food Store
 124. NSW Farmers' Association
 125. Townsville Region Home and Community Care Forum
 126. National Farmers' Federation
 127. Communications, Electrical and Plumbing Union
 128. Public Interest Advocacy Centre
 129. Department of Premier and Cabinet, Queensland
 130. Australian Council of Trade Unions
 131. Brian Buglar
 132. Northern Territory Government
 133. Australian Heritage Commission
 134. Insurance Council of Australia Ltd
 135. Western Australian Municipal Association
 136. Department of Industry Science and Tourism,
Consumer Affairs Division
 137. Town of Port Hedland

Meetings

The Council would like to thank the following people and groups who took the time to discuss this review with the Council:

Robert Albon - Australian National University
Senator Richard Alston

Aboriginal and Torres Strait Islander Commission - Cairns
Aboriginal and Torres Strait Islander Commission - Canberra
Aboriginal and Torres Strait Islander Commission - Darwin
Aboriginal and Torres Strait Islander Commission - Port Hedland
American Express
ANZ Bank
Attorney-General's Department - South Australia
Ausdoc Group Limited
Australian Communications Authority
Australian Local Government Association
Australia Post - Bendigo
Australia Post - Cairns
Australia Post - Castlemaine
Australia Post - Central Office
Australia Post - Mt Isa
Australia Post - North Queensland
Australia Post - Northern Territory
Australia Post - Queensland
Australia Post - South Australia & Northern Territory
Australia Post - Tasmania
Australia Post - Western Australia
Australia Post Agency - Yalgoo
Australian Consumers' Association
Australian Chamber of Commerce and Industry - National Office
Australian Direct Marketing Association
Australian Heritage Commission - Commonwealth
Australian Newsagents' Federation Ltd

Bureau of Transport and Communications Economics -
Commonwealth

Cairns Chamber of Commerce Inc
Cape York Peninsular Development Association Inc
Chamber of Commerce and Industry - Tasmania
Chamber of Commerce and Industry of Western Australia
Chamber of Commerce and Industry of Western Australia
- Port Hedland
Collier Newfield
Commonwealth Bank of Australia
Communications, Electrical and Plumbing Union
Consumer Law Centre
Consumers Federation of Australia
ContacMail
Coopers and Lybrand
Corporate and Public Relations
Crown Solicitors Office - Adelaide

Department of Aboriginal Affairs - Western Australia
Department of Commerce and Trade - Western Australia
Department of Communications and the Arts - Commonwealth
Department of Contract and Management Services - Western Australia
Department of Family and Children's Services
- Western Australia, Port Hedland
Department of Finance and Administration - Commonwealth
Department of Industry, Science and Tourism - Commonwealth
-Consumer Affairs Division
Department of Premier & Cabinet - New South Wales
Department of Premier & Cabinet - Queensland
Department of Premier & Cabinet - Queensland
- Cairns Regional Office
Department of Premier & Cabinet - South Australia
Department of Premier & Cabinet - South Australia Rural
Communities Office
Department of Primary Industries and Fisheries - Northern Territory
Department Primary Industry and Fisheries - Tasmania
Department of Tourism, Small Business and Industry - Mt Isa
Department of Transport and Regional Development - Commonwealth
Department of Treasury - Commonwealth
Department of Treasury - Northern Territory
Department of Treasury - Queensland

Department of Treasury - Western Australia
Department Treasury and Finance - Tasmania
Department of Youth and Community Care - Townsville
Doubleday

Federal Publishing Company- New South Wales

Gulf Local Authorities Development Association
Gulf and Western Queensland Indigenous Council - Mt Isa

Hannanprint
Harlequin Enterprises (Aust) Pty Ltd
Hedland Business Enterprise Centre
Hermes Precisa Australia Pty Ltd
House of Representatives Standing Committee on Communications,
Transport and Microeconomic Reform - Commonwealth
Hutcheons Solicitors - Queensland

Industry Commission
Isolated Children's Parents Association

John Fairfax Group

Licensed Post Office - Maldon
Licensed Post Office - Marong
Licensed Post Office - Newstead
Licensed Post Office - Paynesville
Licensed Post Officers of Australia Ltd
Local Government and Shires Associations of New South Wales
Local Government Association South Australia
Local Government Association of Tasmania
Local Government Association of Northern Territory

Mail-All
Mail Management
Major Mail Users of Australia Limited
Malone, Richard
Mayne Nickless Limited

Mount Isa to Townsville Economic Development Zone
Mt Alexander Shire Council
Municipal Association of Victoria
Ministry of Fair Trading - Western Australia

National Australia Bank
National Farmers' Federation
NRMA Information Services Limited - New South Wales
NSW Farmers' Association
Northern Land Council
Northern Queensland Economic Development Board
Northern Regional Office of the Department of Education
- Queensland
Northern Territory Chamber of Commerce and Industry
Northern Territory Minerals Council

Office of Aboriginal Development - Northern Territory
Office of Consumer & Business Affairs -South Australia
Offset Alpine Printing
Ombudsman - Commonwealth
Open Road
Optus
Outback Queensland Tourism Authority

Pastoralists & Graziers Association of Western Australia
Pastoralists & Graziers Association of Western Australia
- Kimberley Region
Permail Pty Ltd
Pilbara Development Commission
Post Office Agents Association Limited
Power and Water Authority - Northern Territory
Public First
Public Interest Advocacy Centre

QM Industries

Reader's Digest (Aust) Pty Ltd
Retail Delivery Service
Royal Flying Doctor - Queensland Section

South Australian Employers' Chamber of Commerce & Industry
SALMAT
School of Distance Education - Mt Isa
School of Distance Education - Cairns
School of Isolated and Distance Education - Western Australia
Security Mailing Services
Streetfile

Telstra Corporation Limited
The Mailing House
Town of Port Hedland
Townsville City Council
TNT Australia Pty Limited

UPS

Western Australian Chamber of Commerce
Western Australian Municipal Association

Appendix Two: Post Workshops

The Council held workshops on Letter Definition, Access to the Postal Network and the Universal Service Obligation (USO) in Melbourne in December 1997. Each discussion was facilitated by Graeme Samuel, the Council's President. Workshop discussion papers were circulated by the Council prior to each workshop. These included a brief background paper written by the Council and documents provided by some other participants.

Letter Definition Workshop

The purpose of the workshop was to discuss the circumstances under which the current definition of a letter would need to change; and what type of changes would be necessary.

The following organisations attended.

- Australia Post
- Communication Electrical Postal Union
- Department of Communications and the Arts
- Dunhill Madden Butler
- Major Mail Users of Australia
- Mayne Nickless
- Post Office Agents Association
- Readers Digest
- Salmat
- Streetfile

Outcomes

It became obvious during the workshop that much of the concern in the mailing industry centred on the extent of the reserved services rather than the actual definition of letter in the Act. The Act currently uses the definition of a letter as the basis for defining the reserved services so that disputes about what was a letter were really focussed on what should be reserved to Australia Post.

A number of comments were made about the letter definition.

- Some argued that the definition was outdated because technological change has meant that the range of communications which now fall under the definition were not intended to be considered as letters when the legislation was originally drafted.
- Some attendees questioned whether there was a need for a definition in a completely de-regulated market as the definition's only purpose was to determine the reserved services. However, it was suggested that, because the definition is incorporated into other Acts, it remained appropriate to define a letter - no matter what the Council eventually recommended (for example the Act was referred to in Defence Force regulations the Commonwealth Crimes Act).
- It was noted that the definition of letter was needed to give meaning to the Universal Service Obligation of Australia Post.

When discussing appropriate changes to the definition of a letter the following suggestions were made.

- No change.
- Several participants favoured removing business mail from the definition.
- A few felt that because of the size of the business sector, and the difficulty in defining what was meant by business mail, that it was better to define a letter using size and weight parameters, but that these should be reduced.

It was noted that removing business mail from the letter definition would be effective deregulation as 86 per cent of mail originated with business.

There was considerable discussion about how you would define business mail if it was to be excluded from the definition of a letter. The options proposed included the following:

- bulk pre-sort mail ie 2 500 articles. This would assist people in the direct mail business to personalise mail-outs without the fear of infringing the monopoly;
- anything originating from an entity with an ACN number (although it was later accepted that this definition would be too narrow);

- a hand written or printed communication generated by an identifiable individual;
- anything without a stamp on it;
- anything without a stamp, and with reference to size and bulk, thereby avoiding the need for the letter to be personalised; and
- using weight, price and size.

One concern was that the definition chosen should not pull things into the reserved services that were not there before. For example, articles such as loyalty magazines.

Access Workshop

The terms of reference for the review required the Council to look at, among other things, the operation of the current mail interconnection arrangements and the possible application of the general access arrangements under the *Trade Practices Act* to postal services. The purpose of the workshop was to obtain industry views on:

- the extent to which requirements on Australia Post to provide certain interconnection and bulk discount arrangements should be retained in a deregulated postal services market;
- the extent to which postal service activities (that is, mail collection and delivery, sorting, and transportation) should be unbundled as separate access services;
- the most appropriate pricing methodology for access to Australia Post's network under regulated access arrangements; and
- whether the pricing methodology employed should change with changes in the extent of the reserved services.

The following organisations attended.

- Ausdoc Group
- Australia Post
- Communications Electrical Plumbing Union
- Department of Communications and the Arts
- Department of Finance and Administration
- Major Mail Users of Australia
- Mayne Nickless

- Post Office Agents' Association
- Readers Digest
- Streetfile
- TNT

Outcomes

On the issue of future access arrangements for postal services, views were broadly divided into two positions.

A number of attendees held the view that Australia Post's established network, existing relationship with customers and status as the official provider of postal services gave it considerable strength in the postal services market, and therefore an extensive access regime was needed to enable new entrants to compete effectively.

Attendees supporting this position believed that extensive regulated access arrangements should apply to Australia Post's network, encompassing access to mail collection and delivery, sorting, and transportation activities. Within the group supporting these arrangements, one party proposed that an extensive access regime was needed to enable new entrants to compete effectively, while another believed that access arrangements for various levels of Australia Post's network could be commercially negotiated provided regulatory safeguards were in place to deal with disputes. The latter party did not believe Part IIIA, nor section 46, of the *Trade Practices Act* would provide sufficient legislative support for access to Australia Post's network.

Another group held the view that it was difficult to be prescriptive about future access arrangements for postal services, given that new postal service providers would, in a deregulated market, have differing agendas on access arrangements depending on their business strategies and the existing coverage of their respective networks. This group favoured the use of access arrangements akin to those currently in place, provided that access pricing was reviewed.

A general point made in discussions was that, other than for CSO services, Australia Post's network was not static and would become more fluid in a liberalised postal services market. It was also noted by some that access other than at Mail Sorting Centres may not be practicable given the technology and systems Australia Post intends to use to sort mail. It was stressed that in future, *delivery* centres, for example,

may not be able to support third party access given that bar-coded mail will be 'round' sorted at a Mail Sorting Centre before it reaches a delivery centre.

There was general consensus that the segment of Australia Post's network involved in local letter delivery contained the strongest monopoly characteristics. In discussing the areas that new entrants would be unable to service in the absence of access arrangements, mail delivery services to rural and remote areas and post office boxes were both identified. It was noted that:

- in many rural and remote areas, having more than one letter deliverer would be impractical and inefficient;
- physical access for letter delivery to many of Australia Post's post office boxes is not possible;
- most mail delivery and counter services provided in rural and remote areas are supplied by mail contractors; and
- Australia Post does not appear to hold exclusivity over the mail contractors that operate in rural and remote areas.

On issues of pricing, discussion focussed on:

- retail and wholesale pricing in a deregulated postal services market, and the related issue of discriminatory pricing;
- the pricing methodology used for access pricing; and
- pricing issues associated with aggregated mail lodgements.

On the issue of retail and wholesale pricing in a deregulated postal services market, the ability of Australia Post to commercially negotiate different retail, wholesale and interconnect rates with different customers and other service providers (that is, price discriminate) was discussed at length. One view was that the ability to price discriminate provides a dominant market player, providing both retail and wholesale services, with considerable capacity to disadvantage its competitors. Another view was that the ability to price discriminate rightly provides any business with the capacity to defend its market, and that the postal services market is generally contestable given its low barriers to entry. Some considered that a dominant market player engaging in discriminatory pricing which is predatory could be regulated through trade practices laws.

Two approaches to the pricing methodology used for access pricing were discussed. One supported a methodology that derived the actual cost of providing a particular access service. This approach favoured the unbundling of postal access services,

with the calculation of access prices to be non-discriminatory - that is, based on the costs incurred by an access provider in supplying an access service. Another approach supported access prices being based on a discount off the uniform rate of postage (that is, averaged), with a proviso that this approach would be appropriate while there is a uniform rate.

It was noted that arrangements would need to be put in place between interconnecting mail service providers to deal with issues such as lost and delayed mail and complaints about such matters.

Discussions on pricing concluded on issues associated with aggregated mail lodgements. It was noted that there would be different costs associated with processing homogeneous and non-homogeneous aggregated mail lodgements, and that access pricing and standards for mail lodgement would need to reflect this. There were strong and differing views on whether aggregation should be allowed.

Universal Service Obligation Workshop

The purpose of the workshop was to examine the issues relevant to whether Australia Post should be required to offer new USOs (alternatively called CSOs) in relation to:

- financial services;
- post offices; and
- parcel delivery.

Participants were also invited to discuss the quality of Australia Post's letter delivery service (particularly in rural and remote areas).

The following organisations were invited to attend the workshop.

- Aboriginal and Torres Strait Islanders' Commission
- Australia Post
- Australian Consumers' Association
- Australian Local Government Association
- Australian Pensioners' and Superannuants' Federation
- Communications Electrical Plumbing Union
- Consumer Law Centre

- Country Women's Association
- Department of Communications and the Arts
- Department of Finance
- Industry Commission
- Isolated Children's Parents' Association
- Licensed Post Officers of Australian Limited
- Major Mail Users of Australia
- National Caucus of Disability Consumer Organisations
- National Farmers' Federation
- Post Office Agents' Association Limited
- Streetfile

Of these organisations, the Department of Finance, Industry Commission, Isolated Children's Parents' Association, Aboriginal and Torres Strait Islanders' Commission, and the Australian Local Government Association were unable to attend. The Council had, however, also discussed USO issues with all of these groups in separate meetings.

Outcomes

Overall the workshop stressed the importance of the Universal Service provided by Australia Post and stressed that the current standards of service should not be reduced.

Parcel USO

The view was expressed and widely supported, including by community groups, that the letter delivery USO put in place a delivery network which enabled Australia Post, through ordinary commercial means, to provide many other services including parcel delivery. Therefore the key issue behind ensuring parcel delivery was preserving the letter delivery USO.

The point was made that a specific USO relating to parcels would distort competition in the market for parcel delivery.

Some participants suggested that there are more efficient ways of providing a parcel CSO targeted at rural areas and limited to say educational and health materials, eg for the educational institution posting the materials to obtain a subsidy from the

government. Further, receipt of educational materials by post is only one of a range of issues involved in considering the most efficient way to provide rural education.

There was general consensus that a specific Parcel USO was not necessary.

Financial Services USO

Post offices provide a number of services besides postal functions. These include bill paying, money transactions and supplying information. All agreed on the importance of these services. However, most felt that Australia Post and the post office network should not have to carry a CSO to provide these types of services; The view was expressed that “How can you expect Australia Post to provide these services just because other services have left a town?”.

A few argued that Australia Post should carry a financial services USO.

Australia Post does not have a long history in the provision of financial services, and it has only ever acted as an agent for financial institutions. If Australia Post was obliged to provide these services, its negotiating power with the financial institutions would be severely weakened.

Alternatively, as the USO requires Australia Post to provide reasonable access to postal services the network Australia Post uses to meet this obligation would act as a building block to provide a range of other services such as financial services. If this alternative view were accepted it would be important that the regulations did not stifle Australia Post’s ability to manage its business in the most efficient way.

Some thought that while financial services should be provided through the mechanism of a CSO it was the government’s responsibility and not Australia Post’s. According to this view, the Government might wish to pay Australia Post to provide these services.

Post Office USO

It may be possible to introduce a requirement to have a specified minimum number of post offices. However, it makes little sense to require post offices to be in specified places because it would be too inflexible to take into account shifts in population and demand. The emphasis should be on providing the letter delivery service, and access

to that service. In practice this has meant the retention of an extensive network of postal outlets.

Australia Post's letter delivery USO

In general, people are reasonably content with the level of Australia Post's performance in letter and parcel delivery.

Postal services have not been displaced by the growth in the electronic messaging market.

There was no support for the idea to limit the CSO to deliveries in rural and remote areas. The purpose of the USO is to bind the nation. Further, the notion of a postal CSO relates to end-to-end delivery of an article, whether one end is in the bush or overseas. Therefore it makes little sense to limit the USO to rural and remote areas. There were some concerns about the frequency of mail delivery.

There was little support to require Australia Post to contract out further segments of its operations. The view was taken that this was a commercial decision for Australia Post to make, and that Australia Post have already contracted out most of the operations where there were cost savings to be made from contracting out.

In relation to complaint handling, the Commonwealth Ombudsman only has power to examine the actions of Australia Post and its employees. It cannot examine the actions of contractors. However, it can criticise Australia Post for failing to take action against a contractor that breaches the terms of its contract with Australia Post. In the service charter, Australia Post takes full responsibility for the actions of contractors. Some argued that if the letter delivery industry were deregulated there may be a need for more extensive regulation in relation to complaints handling. Others argued that the marketplace would provide its own disciplines on poor performers in that customers would switch to other operators.

Business would prefer performance standards to be defined as part of a partnership between business and Australia Post. One argued that setting performance standards was a difficult but necessary task. Australia Post argued that the flexibility needed to provide the letter delivery service precluded the use of rigid standards.

There was general support for retaining cross-subsidy funding of the CSO. A concern with direct funding was that funding was unstable and could be cut. A concern with

an industry levy was that (1) there are few ways of accurately measuring the market-share of participants on which to base collection of the levy; (2) measurement would be further complicated if many competitors entered the market.

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